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IN THE

Supreme Court of the United States

OCTOBER TERM 1961

No. [redacted] 153

MEMPHIS TRANSIT COMPANY,
Petitioner,

v.

THE UNITED STATES,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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THE UNITED STATES,

Respondent.

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Memphis Transit Company, your petitioner, respectfully prays that a Writ of Certiorari be issued to review the order and judgment of the United States Court of Claims dismissing its petition to that Court. A certified transcript of the record is furnished herewith in accordance with Rule 21(1) of the Rules of this Court.

Opinion Below

The opinion and findings of the fact of the United States Court of Claims in petitioner's case are printed in Appendix A hereto, *infra*, pp. 1a-31a, and are reported at 297 F. 2d 542.

Jurisdiction

The order and judgment of the United States Court of Claims was entered on December 6, 1961 (*infra*, Appendix

A hereto, p. 8a). The Court entertained petitioner's timely motion for a rehearing and overruled the same on March 7, 1962. The jurisdiction of this Court is invoked under the provisions of Title 28, United States Code, Section 1255(1).

Questions Presented

(1) Whether the petitioner issued 25,000 shares of its common stock on December 18, 1905 in part consideration for properties acquired from the Memphis Street Railway Extension Company on that date?[1]

(2) Whether in determining petitioner's equity invested capital applicable to the year 1944 effect should be given, in computing earnings and profits at the beginning of said year, to the final tax liability for the taxable period April 1, 1943 to December 31, 1943 after giving due effect to the reduction of the amount of such liability arising from the application of carrybacks of net operating losses and unused excess profits credits applicable in computing said final tax liability?

(3) Whether in determining petitioner's equity invested capital applicable to the year 1944 effect should be given, in computing the unused excess profits credit carrybacks arising in respect of calendar years 1945 and 1946 applicable in computing the excess profits credit for the year 1944, to the final tax liability for the year 1944 after giving

[1] The parties stipulated in the Court below the methods of determining the petitioner's additional abandonment losses for 1945, 1946 and 1947 and the addition to its equity invested capital for the taxable period April 1, 1943 to December 31, 1943, 1944, 1945 and 1946 in the event that the Court below found that the 25,000 shares of petitioner's common stock were issued in part consideration for Memphis Street Railway Extension Company's properties and found a fair market value for such stock.

due effect to the reduction of the amount of such liability arising from the application of carrybacks of net operating losses and unused excess profits credits applicable in computing said final tax liability?

Statutes Involved

The statutes involved in this case are sections of the Internal Revenue Code of 1939 as applicable to the years 1943 through 1947. The specific sections of the Internal Revenue Code of 1939 which are controlling in this case are Sections 23(f), 23(l), 113(a), 718(a). These sections of the Internal Revenue Code of 1939, together with Treasury regulations, are set forth in pertinent part in Appendix C hereto, *infra*, pp. 1c-5c.

Statement of the Case

Memphis Transit Company, petitioner herein, brought an action against the United States in the United States Court of Claims to recover a part of the United States income and excess profits taxes paid by it for the taxable period April 1, 1943 to December 31, 1943 (hereinafter sometimes referred to as the 1943 period) and for the calendar years 1944 and 1947 in the respective amounts of $333,627.58, $463,481.36 and $52,368.75. The jurisdiction of the United States Court of Claims in this case is based on Title 28, United States Code, Section 1491 which grants jurisdiction to that Court to render judgment upon any claim against the United States founded upon any Act of Congress.

Essentially, the facts of this case are that petitioner, Memphis Transit Company (the name of which corporation was The Memphis Street Railway Company prior to March 21, 1958), was engaged primarily in the operation

of an electric street railway system in the City of Memphis prior to 1945. The electric street railway system was abandoned in 1945, 1946 and 1947, and thereafter petitioner engaged in the operation of a motor bus and trackless trolley system. Petitioner maintains its books and files its tax returns on the accrual and calendar year basis.

In 1904, petitioner was engaged in operating a street railway system in the City of Memphis. In February of that year, there was incorporated The Memphis Street Railway Extension Company (hereinafter sometimes referred to as Extension Company). This corporation issued 500 shares of stock, of which 496 were issued to W. S. McCrea who was a secretary and director of petitioner and the remaining 4 shares were issued to other individuals. At that time petitioner had outstanding 5,000 shares of common stock, of which 3,331 shares were owned by C. K. G. Billings, 1,666 shares were owned by Frank G. Jones, and the remaining 3 were owned by other individuals.

On or about February 22, 1905, Extension Company received a franchise from the Legislative Council of the City of Memphis to construct, operate and maintain a street railway system over certain streets in the City of Memphis, which lines would connect to the lines owned and operated by petitioner. Acting under the authority of said franchise, Extension Company entered into an engineering contract with Ford, Bacon & Davis, as a result of which 14.9 miles of lines were constructed prior to December 18, 1905, consisting of 27 extensions to petitioner's system. During this period, Extension Company also acquired cars, powerhouse equipment, carhouses, buildings, fixtures and miscellaneous equipment required for the operation of the railway lines constructed by it. Its construction

costs as of December 18, 1905 as shown by its books of account totaled $700,000, but said books did not contain any recorded asset account or value for Extension Company's franchise to construct, operate and maintain street railway lines in the City of Memphis, or for other intangibles.

On March 4, 1905, W. S. McCrea assigned his 496 shares of Extension Company to Ford, Bacon & Davis. As a consequence of subsequent transfers, on December 18, 1905 Extension Company's stock was held as follows: Isidore Newman & Sons—495 shares; five individuals—1 share each.

On March 4, 1905, all of the outstanding shares of petitioner's capital stock were assigned to Isidore Newman & Sons, Trustees. As a consequence of subsequent transfers, on December 18, 1905 the stock of petitioner was held as follows: Isidore Newman & Sons, Trustees—4,989 shares; eleven individuals—1 share each.

Extension Company entered into a contract with petitioner on December 18, 1905, under which it agreed to sell to petitioner "all its property, real, personal and mixed, and its franchises, immunities, rights and privileges, with the exception of its franchise or right to be a corporation." The transfer of these properties was to be free and clear of all indebtedness except for the outstanding liability of Extension Company to pay $650,000 of its promissory notes held by Isidore Newman & Sons which the Extension Company agreed to pay upon receipt of the purchase price from petitioner. The purchase price agreed upon was 25,000 shares of petitioner's common stock in the aggregate amount of $2,500,000 par value and $700,000 principal amount of petitioner's Consolidated Mortgage 5 Percent Gold Bonds. The contract was carried out according to its terms.

Before entering into the contract referred to above, petitioner had no outstanding preferred stock and only 5,000 shares of common stock. Petitioner's stockholders, however, on December 18, 1905, authorized the issuance of 25,000 shares of preferred stock and approved an exchange pursuant to which the old common stock was retired and the holders thereof were issued 25,000 shares of the new preferred stock having a par value of $100 per share. At the same time the petitioner's stockholders approved the issuance of 25,000 shares of the new $100 par value common stock to the Extension Company together with the $700,000 of petitioner's Consolidated Mortgage 5 Percent Gold Bonds in exchange for Extension Company's assets under the Contract as hereinabove described.

During the years 1945, 1946 and 1947, the petitioner abandoned its street railway operations (including that part of its operations attributable to the properties acquired on December 18, 1905) and substituted therefor motor bus and trackless trolley operations. Petitioner over said three year period was allowed a loss deduction by the Internal Revenue Service in respect of the obsolescence and abandonment of the street railway properties but the cost basis of all of the petitioner's properties, applicable in part in the determination of such loss, as established by the Internal Revenue Service, did not include any cost in respect to the 25,000 shares of petitioner's common stock issued as part consideration for the Extension Company's properties acquired by petitioner on December 18, 1905.

Further, in computing the petitioner's excess profits tax liability for the taxable 1943 period and the year 1944 by application of an excess profits credit determined in accordance with the invested capital method as provided in Section 718 of the 1939 Code, the portion of petitioner's

equity invested capital referable to capital stock, as established by the Internal Revenue Service for the 1943 period, and the years 1944, 1945 and 1946 did not include any value for the said 25,000 shares of common stock issued on December 18, 1905.

Claims for refund were duly filed by the petitioner with the Commissioner of Internal Revenue for the taxable period April 1943 to December 31, 1943[2] and for the calendar years 1944 and 1947 claiming additional abondonment losses applicable to the years 1945, 1946[3] and 1947 with respect to the property acquired in exchange for the 25,000 shares of common stock issued for the Extension Company properties on the basis of a fair market value for said stock of $73.50 per share; claiming an increase by the same amount in its equity invested capital for purposes of computing its excess profits tax liability for the 1943 period and the calendar year 1944; and claiming petitioner's right, for the purpose of determining its excess profits tax credit for the year 1944 including excess profits tax credit carrybacks and carryovers to such year, to subtract from earnings and profits prior to reduction thereof for federal income and excess profits taxes only the amount of such taxes computed after giving due effect to net operating loss and excess profits tax credit carrybacks.

Petitioner's contentions, as set forth in the aforesaid claims, were formally rejected by the Commissioner of

[2] For the period January 1, 1943 to March 31, 1943 petitioner's return was included in the consolidated return filed by National Power and Light Company and subsidiary companies. No issue is presented here as to such return.

[3] No recoveries were claimed by petitioner for 1945 and 1946 because no tax was paid for these years. However, the additional abandonment losses, if allowed, have an effect on the net operating loss carrybacks and unused excess profits carrybacks to the 1943 period and the year 1944 if petitioner prevails with respect to issues (2) and (3) set forth in the Statement of Questions.

Internal Revenue and the action was duly commenced in the Court below.

On December 6, 1961 the Court of Claims found that the 25,000 shares of common stock issued on December 18, 1905 had a fair market value of $70 per share but that the stock was not issued in part consideration for Extension Company properties and therefore the petitioner was not entitled to additional abandonment losses for 1945, 1946 and 1947, nor was it entitled to an increase in its equity invested capital for purposes of computing its excess profits tax liability for the 1943 period and the calendar year 1944. The Court below also rejected the petitioner's contentions relating to the computation of its accumulated earnings and profits for purposes of calculating excess profits tax credits for the 1943 period and the calendar year 1944.

The Court below entertained the petitioner's motion for a rehearing, duly filed, which it overruled on March 7, 1961.

REASONS FOR GRANTING THE WRIT

I

The decision of the United States Court of Claims below pertaining to the issue of whether in fact the petitioner issued 25,000 shares of its common stock in the aggregate amount of $2,500,000 par value in part consideration for properties acquired from the Memphis Street Railway Extension Company on December 18, 1905 has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

II

The decision of the Court below with respect to the issue of the method of determining accumulated earnings and profits for the purpose of calculating the petitioner's excess profits tax credits and therefore its excess profits tax liability for the periods April 1, 1943 to December 31, 1943 and for 1944 is, in principle, in conflict with decisions in the United States Courts of Appeals for the Sixth Circuit and the Ninth Circuit.

These reasons will be fully explained below.

I

The decision of the United States Court of Claims below pertaining to the issue of whether in fact the petitioner issued 25,000 shares of its common stock in the aggregate amount of $2,500,000 par value in part consideration for properties acquired from the Memphis Street Railway Extension Company on December 18, 1905 has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

An issue for decision in this case as to whether the petitioner is entitled to additional abandonment losses for the years 1945, 1946 and 1947, and as to whether the petitioner's equity invested capital should be increased for the 1943 period and for the years 1944, 1945 and 1946 in order to ascertain the petitioner's excess profits tax liability for the 1943 period and for the calendar year 1944, depends on whether in fact the petitioner issued 25,000 shares of its common stock on December 18, 1905 in part consideration for properties acquired by petitioner

from the Extension Company, and the fair market value of such stock.

The evidence in respect to this issue presented to the Court below was contained in a stipulation of facts (*infra*, Appendix B, pp. 1b-24b). The Court found from this evidence as presented that the 25,000 shares of common stock issued by the petitioner to Extension Company on December 18, 1905 in exchange for the properties of the latter company had a fair market value of $70 per share, but that said stock was not in fact issued as part of the consideration for the properties.

In finding that the 25,000 shares of common stock were not part of the consideration for the properties, the Court below committed clear and exceptional error in its disregard of the evidence as presented, and its departure from the accepted and usual course of a judicial proceeding calls for the exercise of this Court's power of supervision. While it is recognized by the petitioner that this Court will not ordinarily grant certiorari to review the judgment of a lower court based solely on questions of fact, it is equally clear that this Court will grant a writ where the record before the lower court presented clear and overwhelming proof of facts contrary to the lower court's findings of fact; *cf. National Labor Relations Board* v. *Waterman Steamship Corporation*, 309 U. S. 206 (1940). It is respectfully submitted that the findings of the Court below are contrary to the proof of the facts in this case.

The essence of the decision of the Court below lies in its ultimate findings of fact at Paragraphs 26, 28 and 30 (*infra*, Appendix A, pp. 27a, 28a, 30a), which are in pertinent part:

> "26. In finding 14 it was determined that the fair market value of plaintiff's new common stock

authorized December 18, 1905, was reasonably $70 per share. There is no satisfactory evidence that the 25,000 shares of plaintiff's common stock issued to the Extension Company were truly a part of the consideration for the assets acquired by plaintiff through an indenture and conveyance by the Extension Company to the plaintiff dated December 18, 1905.

The true stockowners of the plaintiff company and the Extension Company at December 18, 1905, when the transactions occurred, are not determinable from the evidence. It is reasonable to conclude that they were identical (see findings 10 and 11). When the Extension Company was organized on February 21, 1905, it issued 500 shares of capital stock, of which 496 shares were issued to W. S. McCrea, plaintiff's secretary and a director, obviously the 'straw man' or nonentity.

* * * * *

"28. * * * Considering all of the evidence in this case, it is reasonable to conclude that the stockholders of the Extension Company and the plaintiff were identical and that 25,000 shares of plaintiff's common stock were indirectly paid to plaintiff's own stockholders.

* * * * *

"30. The Extension Company had not fully developed its franchise and had never operated any part of it. There is no evidence that the Extension Company had ever intended to operate its franchise or that it could have been operated profitably, except as an adjunct of the plaintiff's system.

It is reasonable to conclude that the $700,000 of 5 percent bonds issued by the plaintiff as of December 18, 1905, represented the fair and reasonable net value of all assets acquired by the plaintiff from the Extension Company and that no consideration

can be reasonably attributable to the 25,000 shares of its common stock as a part of the consideration of such assets, as set forth in the proposed agreement of December 18, 1905, by the Extension Company * * *."

The above findings by the Court below are inconsistent with and unsupported by the facts contained in the stipulation. Paragraph 12 of said stipulation states (*infra*, Appendix B, p. 7b):

> "12. In an offer dated December 18, 1905 set forth in the minutes of a meeting of stockholders of Extension Company held on the same date, a true copy of said minutes being hereto attached as Exhibit E, *Extension Company offered to convey to plaintiff 'all its property, real, personal and mixed, and its franchises, immunities, rights and privileges, with the exception of its franchises or right to be a corporation.'* These properties are described in detail at Exhibit E-1, which is the minutes of an adjourned special meeting of the board of directors of Extension Company held at 6:00 P.M. on December 18, 1905. The transfer of these properties was to be free and clear of all indebtedness except for the outstanding liability of Extension Company to pay off $650,000 of its promissory notes which Extension Company agreed to pay upon receipt of the purchase price. *In return, plaintiff was to pay a purchase price of 25,000 shares of plaintiff's common capital stock in the aggregate amount of $2,500,000 par value and $700,000 principal amount of plaintiff's Consolidated Mortgage 5% Gold Bonds.* Extension Company's offer was approved by plaintiff's stockholders at an adjourned special meeting of said stockholders held December 18, 1905 and was accepted by plaintiff's officers under authority of the directors of plaintiff at a meeting of plaintiff's directors held December 18, 1905. *Said agreement was carried out according to its*

terms as shown by minutes of an adjourned special meeting of the board of directors of Extension Company held at 6:00 P.M. December 18, 1905; see Exhibit E-1." (Emphasis supplied.)

The above stipulation positively establishes the essential fact that the 25,000 shares of the petitioner's (referred to as 'plaintiff' in the above quoted stipulation) common stock were issued as a part of an undivided consideration for all of the Extension Company's properties including that Company's franchises, immunities, rights and privileges (other than its corporate franchise). In so finding that the $700,000 of the petitioner's bonds were the sole consideration for the aforesaid properties of the Extension Company, the Court below committed clear and exceptional error. Not only did the Court below find contrary to the facts as established by the evidence in the record, but its finding that petitioner's bonds were the sole consideration for the subject properties goes beyond the four corners of the evidence presented and constitutes a violation of its judicial function.

It is respectfully submitted that the United States Court of Claims' finding that petitioner paid only $700,000 of its bonds for the properties purchased from Extension Company where petitioner and respondent had stipulated that petitioner paid a purchase price consisting not only of the $700,000 of petitioner's bonds but also of 25,000 shares of petitioner's common stock is a clear departure from the accepted and usual course of a judicial proceeding which calls for an exercise of this Court's power of supervision.

II

The decision of the Court below with respect to the issue of the method of determining accumulated earnings and profits for the purpose of calculating the petitioner's excess profits tax credits and therefore its excess profits tax liability for the periods April 1, 1943 to December 31, 1943 and for the year 1944 is, in principle, in conflict with decisions in the United States Court of Appeals for the Sixth Circuit and the Ninth Circuit.

The decision of the Court below denied the petitioner the right for the purpose of calculating excess profits tax credits to compute its earnings and profits as of the close of the 1943 taxable period and the year 1944 so as to reflect the income and excess profits tax liabilities for these years after giving due effect to the reduction of such tax liabilities by application of the net operating loss and unused excess profits credit carrybacks from the years 1945 and 1946.

Petitioner requested the United States Court of Claims to accept the view that accumulated earnings and profits should reflect a corporation's "true financial status" as of the end of the taxable year for the purpose of computing the excess profits tax credit for the subsequent taxable year and therefore should be computed by subtracting the corporation's ultimate tax liability for the year regardless of whether such tax liability was determinable at the end of the year or depended on events occurring in subsequent years which affected such tax liability such as carrybacks of net operating losses and unused excess profits tax credits from subsequent years. Petitioner relied on decisions by two United States Courts of Appeals that earnings and profits should reflect "true financial status" and therefore the ultimate proper tax liability for the year even though such liability could not have been accrued as

of the end of the year for the purpose of ascertaining the effect of such liability upon net income and depended for its determination on events occurring in subsequent years.

> *F. W. Drybrough et al. v. Commissioner of Internal Revenue*, 238 F. 2d 735 (6th Cir. 1956); *Pacific Affiliate, Inc. v. Commissioner of Internal Revenue*, 224 F. 2d 578 (9th Cir. 1955), cert. den. 350 U. S. 976 (1956).

In *F. W. Drybrough et al. v. Commissioner of Internal Revenue, supra*, the Commissioner had asserted and the Tax Court upheld deficiencies against a corporation for failure to report receipt of diverted funds in its income and excess profits tax returns for the years 1942 through 1946. The aforesaid funds of the corporation were secretly diverted over the five year period by individuals who were the majority stockholders and in dominant control of the corporation during the years in question. The Commissioner also determined that the entire amount of the diverted funds constituted taxable dividends to the individual stockholders (the appellants in the subject case) and accordingly asserted deficiencies and civil fraud penalties against the stockholders individually which the Tax Court also sustained.

The Court of Appeals held that the diverted funds were only taxable as dividends to the stockholders to the extent that the corporation had earnings and profits for the years in which the funds were withdrawn. On the earnings and profits issue, the Court held that the corporation's ultimate tax liabilities for the years 1942 through 1946 as set forth in the deficiencies found by the Tax Court in 1955 must be deducted in computing earnings and profits for the

years 1942 through 1946 even though such deficiencies were contested until 1955 and the liability therefor depended on an event subsequent to the years 1942 through 1946 *i.e.* a determination by the Tax Court long after the close of such years. Therefore, the Court of Appeals for the Sixth Circuit held that earnings and profits must reflect a corporation's true financial status even though such true financial status may be dependent on events that do not occur until after the close of the taxable year.

In *Pacific Affiliate, Inc.* v. *Commissioner of Internal Revenue, supra,* the Court of Appeals for the Ninth Circuit held that for the purpose of computing invested capital as of the end of 1943, the computation of earnings and profits should be made by subtracting an amount of federal income tax liability that was disputed as of the end of 1943 and not ultimately found as a liability by the Tax Court until 1952. Here again, a United States Court of Appeals held that earnings and profits must reflect true financial status as of the end of the year even though such determination turned on an event long after the end of the year, *i.e.* a decision by the Tax Court.

It is respectfully submitted that the decision of the Court below holding that net operating loss and unused excess profits credit carrybacks do not affect federal tax liability of the year to which such carrybacks are carried for the purpose of computing accumulated earnings and profits at the end of such year conflicts with the principles adopted by the United States Courts of Appeals for the Sixth Circuit and for the Ninth Circuit in the above decisions.

In reaching its conclusion in petitioner's case, the Court below relied on the decision of this Court in *Lewyt Corporation* v. *Commissioner of Internal Revenue,* 349 U. S. 237 (1955) to the effect that, for the purpose of

calculating the net operating loss *deduction from income* under Section 122(d)(6) of the Internal Revenue Code of 1939, excess profits tax liability for a taxable year must be computed without giving effect to a net operating loss carryback. The United States Court of Appeals for the Ninth Circuit in *Pacific Affiliate, Inc.* v. *Commissioner of Internal Revenue, supra*, distinguished the decision in *Lewyt Corporation* v. *Commissioner of Internal Revenue, supra*, on the ground that it concerned the computation of income and not the computation of earnings and profits where the doctrine of true financial status applied. The Court of Appeals said:

> "*Lewyt, supra*, in no respect challenges the distinction made by the Tax Court. In *Lewyt* the Supreme Court affirmed the Court of Appeals so far as it followed the rule of *Dixie Pine Co.* v. *Commissioner, supra*, and *Security Mills Co.* v. *Commissioner, supra*. The primary issue involved in the tax litigation there was the interpretation and application of 26 U.S.C. §122(d)(6) in computing net operating loss deductions from income. The opinion of the Supreme Court in reversing in part the decision of the lower court as well as the dissenting opinion of Justice Frankfurter clearly indicates that the decision should be narrowly confined to an interpretation of the statutory *language* of said section 122(d)(6) of the Internal Revenue Code. We are of the opinion that the decision does not lessen the validity of the distinction made by the Tax Court in not applying the rule of *Dixie Pine Co.* and *Security Mills Co., supra*, when dealing with the accrual of federal income and excess profits taxes called for by Treasury Regulation 112, Section 35.718-2(a)." (224 F.2d 578, 580.)

From the aforesaid, it is clear that the decision of the United States Court of Claims also conflicts in principle with the decision of the United States Court of Appeals for the Ninth Circuit in interpreting the meaning of the Court's decision in *Lewyt Corporation* v. *Commissioner of Internal Revenue, supra.*

Therefore, it is submitted that this petition should be granted for the reason that the decision of the United States Court of Claims conflicts in principle with the decisions of the United States Court of Appeals for the Sixth Circuit and the United States Court of Appeals for the Ninth Circuit.

Conclusion

The writ of certiorari to the United States Court of Claims should be granted for the following reasons:

(1) That the decision of that Court insofar as the finding that the petitioner did not in fact issue 25,000 shares of its common stock as part consideration for the properties acquired from the Memphis Street Railway Extension Company on December 18, 1905 has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

(2) That the decision of that Court in respect to its rejection of the petitioner's method of determining accumulated earnings and profits for the purpose of calculating its excess profits tax credits in determining its excess profits tax liability is, in principle, in conflict with

the decisions of the Courts of Appeals for the Sixth Circuit and the Ninth Circuit.

Respectfully submitted,

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APPENDIX A

Opinion and Judgment of the United States Court of Claims in Petitioner's Case

IN THE

United States Court of Claims

No. 355-57

(Decided December 6, 1961)

MEMPHIS TRANSIT COMPANY *v.* THE UNITED STATES

OPINION

LARAMORE, *Judge*, delivered the opinion of the court:

This is a suit for refund of income and excess profits taxes for the years 1943, 1944, and 1947.

The taxpayer corporation is engaged primarily in the operation of a motor bus and trackless trolley system in the City of Memphis, Tennessee. Prior to 1945, taxpayer operated an electric street railway system in Memphis, but this operation was abandoned in 1945, 1946, and 1947. As a result of this abandonment the taxpayer incurred an obvious loss. The Internal Revenue Service recognized that a loss occurred and allowed abandonment losses for the years 1945, 1946, and 1947. There is no dispute as to the method used in determining the amount of the loss recognized, but there exists a dispute as to the amount. The basis for the dispute is the difference of opinion as to the cost of taxpayer's property as of December 31,

1912. The defendant contends that this cost was $9,843,000, which is equivalent to $9,343,000 of plaintiff's bonds outstanding, plus $500,000 in cash originally paid on common stock when the company was organized. The plaintiff contends that this amount should be increased by the 1905 fair market value of 25,000 shares of its common stock which it is claimed was paid on December 18, 1905 as part consideration for the acquisition of property received by it from the Memphis Street Railway Extension Company (hereinafter sometimes referred to as the Extension Company). Therefore, other factors being constant, an increase in the cost of the plaintiff's property would naturally result in a greater loss when that property was abandoned. It would, in addition, increase taxpayer's equity invested capital which is a figure used in determining excess profits.

To resolve this dispute, we must determine whether plaintiff issued the 25,000 shares of stock as part consideration for property received by it.

In February of 1905 the Extension Company received a franchise to operate and maintain a street railway system over certain streets in Memphis. The lines were to be extensions of the plaintiff's then existing lines. The Extension Company maintained its own corporate minutes, stock certificate books and books of account. The Extension Company held directors' meetings, purchased materials and borrowed money. As of December 18, 1905, it had assets of $700,000. However, as of that date the Extension Company had realized no receipts from operations. On that date 495 shares of the Extension Company's 500 shares outstanding were held by Isidore Newman & Sons. Similarly, of plaintiff's 5,000 shares

outstanding, 4,989 shares were held by the same Isidore Newman & Sons. On December 18, 1905, the Extension Company entered into a contract with plaintiff whereby it agreed to sell to plaintiff all its property. The purchase price agreed upon was 25,000 shares of plaintiff's common stock (par value of $2,500,000) and $700,000 in five percent gold bonds. Before entering into the contract, plaintiff had no outstanding preferred stock and only 5,000 shares of common stock. Plaintiff's stockholders, on December 18, 1905, authorized 25,000 shares of preferred stock to be given to the holders of the old common stock and that the old common stock be retired. They further authorized the issuance of 25,000 shares of new common stock which was to be given to the Extension Company. It is the transfer of this stock that gives rise to the principal part of the present controversy.

The first overall question presented by this case is: Did the taxpayer acquire property for its stock in an arm's length transaction in 1905, when it paid $700,000 in bonds for property of Memphis Street Railway Extension Company, having a tangible value of no more than $700,000, and in addition issued 25,000 shares of common stock having a par value of $2,500,000 to an affiliate or alter ego of the person owning approximately 99 percent of its stock?

The resolution of two legal questions depends on the answer to the first overall question: (1) whether the taxpayer's equity invested capital should be greater than that allowed by the Commissioner of Internal Revenue in computing taxpayer's excess profits tax for the period April 1, 1943 to December 31, 1943, and for the calendar year 1944; (2) whether taxpayer sustained a greater loss than allowed by the Commissioner of Internal Revenue as a result of

the abandonment of its street railway lines in 1945, 1946, and 1947.

The solution of the first overall question lies in the facts of this case. The evidence shows, and the commissioner has found, which finding we adopt, that no satisfactory evidence is presented that the 25,000 shares of plaintiff's common stock issued to the Extension Company were truly a part of the consideration for the assets acquired by plaintiff through an indenture and conveyance by the Extension Company to the plaintiff dated December 18, 1905 (finding 26).

This court said in *Republic Steel Corp.* v. *United States*, 141 Ct. Cl. 499, 503:

> * * * However, the declared purpose of the parties is not necessarily controlling. Of more significance is what the parties actually did. Thus, substance, and not form, governs in this type of controversy. *Weiss* v. *Stearn*, 265 U.S. 242.

Therefore, this court will not permit the corporate image to serve as blinders when it seeks to answer the question as to what actually occurred here, but will look at the facts in each situation. The pertinent facts in the instant case may be summarized as follows:

The stockholders were the same. The taxpayer had never established an evaluation of its franchise on its own books, and there is no evidence that the plaintiff had established or determined any value for the franchise acquired from the Extension Company on December 18, 1905. There is no evidence that plaintiff's earnings were sufficiently increased after the acquisition of the additional franchise and other assets of the Extension Company whereby a reasonable

determination of value of such franchise might be made. The Extension Company had not fully developed its franchise and had never operated any part of it, nor is there evidence that the Extension Company ever intended to operate its franchise or that it could have operated profitably, except as an adjunct to plaintiff's system. Therefore, the plaintiff has totally failed to sustain its burden to prove the value that could be reasonably ascribed to the franchise in excess of $700,000. Finally, the facts show that the $700,000 of five percent bonds issued by plaintiff as of October 18, 1905, represented the fair and reasonable net value of all the assets acquired by the plaintiff from the Extension Company, and that no consideration can be reasonably attributable to the 25,000 shares of its common stock as a part of the consideration of such assets, as set forth in the proposed agreement of December 18, 1905 by the Extension Company.

In short, the two corporations were owned by the same interest. The $700,000 of improvements to taxpayer's lines were transferred to taxpayer when completed, and in the course of this transfer 25,000 shares of taxpayer's common stock were issued to Isidore Newman & Sons.

It follows as a necessary result of our determination that the plaintiff's equity invested capital should not be increased by any value ascribed to the 25,000 shares of common stock and that taxpayer did not sustain a loss greater than that allowed by the Commissioner of Internal Revenue. This is so because both parties agree as to the method of computation and the total cost of plaintiff's tangible property, leaving as the only dispute the question as to whether the value of the 25,000 shares should be added to plaintiff's

cost on December 31, 1912. Since we hold that the value of the 25,000 shares should not be added to plaintiff's cost, it follows that the cost attributable to intangibles as determined by the Commissioner was correct.

In the light of the facts above recited, but one conclusion can be reached—that taxpayer's equity invested capital used in computing its excess profits tax and taxpayer's obsolescence loss were correctly computed by the Commissioner of Internal Revenue.[1] Consequently, plaintiff cannot recover on this item of its claim.

The second and final question presented involves plaintiff's claim that its earnings and profits as of the close of the years 1943 and 1944 should be recomputed so as to reflect the income and excess profits tax liabilities found to be owing by plaintiff for these years. This, plaintiff asserts, should be done by taking into account the effect upon such liabilities of the adjustment which would be applicable to these years by applying the net operating loss and unused excess profits credit carrybacks for the years 1945 and 1946. The result of this would be an increase in accumulated earnings and profits existing at the beginning of 1944 and 1945, which in turn would increase the excess profits credits for 1944 and 1945, thus reducing the adjusted excess profits net income subject to tax for these years.

Despite an Internal Revenue ruling[2] which expressly bars such a result, plaintiff seeks such an adjustment on the general rule that with regard to earnings and profits the amount thereof should reflect the corporation's true

[1] See finding 17.

[2] Rev. Rul. 55-28, 1955-1 Cum. Bull. 359.

financial condition as of the end of the taxable year, regardless of whether or not all of the events and determinations have occurred at that time. Plaintiff cites several cases, principally *Stern Brothers & Co.*, 16 T.C. 295 (1951), which have applied this rule. However, the cases cited dealt with disputed tax liabilities which arose for the very year for which the earnings and profits were sought to be recomputed and none involved the situation here; *i.e.*, of applying to prior years tax consequences which arose in subsequent years.

Defendant relies on the Supreme Court decision in *Lewyt Corporation v. Commissioner*, 349 U. S. 237 (1955) in opposition to plaintiff's claim. There it was held that for the purpose of computing a net operating loss carryback from 1946 to 1944 and hence to 1945, the excess profits tax deductible for 1944 was such excess profits tax as computed without giving effect to the allowance of the net operating loss carryback. Plaintiff seeks to distinguish that holding from the situation here on the ground that what was involved in *Lewyt* was the computation of a net operating loss carryback rather than the computation of earnings and profits, and that since the latter are basic to the determination of the real financial condition of a corporation they must be computed with regard to events and determinations which occur in subsequent years.

However, as pointed out above, the theory which plaintiff seeks to apply and the cases relied on in support thereof deal with situations or events which arose prior to or at the close of the taxable year in question, with only the settlement of the dispute which they gave rise to being determined in a subsequent year. This, of course, is not

the situation here where the adjustment or carryback which is sought to be applied is dependent upon facts which relate not to the taxable year but some later year.

The adjustment which plaintiff urges here is, of course, not in conformity with the general rule of tax reporting when the taxpayer is on the accrual method. The holding of the *Stern Brothers* case, *supra*, and the cases which have followed it are recognized as providing an exception to this general rule. The exception in the *Stern Brothers* case, *supra*, is applicable where it is conceivable that the full tax could have been determined and paid in the taxable year. This would be impossible in the case at bar. Plaintiff has received the benefit intended by the net operating loss and unused excess profits credit carrybacks. Such a further extension as plaintiff requests is barred by the Internal Revenue ruling cited above and we believe would be contra to the rationale of the *Lewyt* decision, *supra*.

Plaintiff is not entitled to recover, and its petition will be dismissed.

It is so ordered.

DURFEE, *Judge;* WHITAKER, *Judge;* and JONES, *Chief Judge*, concur.

FINDINGS OF FACT

The court, having considered the evidence, the report of Trial Commissioner Marion T. Bennett, and the briefs and argument of counsel, makes findings of fact as follows:

1. The taxpayer corporation, Memphis Transit Company, is a corporation duly organized and existing under the laws of the State of Tennessee, having been incorpo-

rated on March 28, 1895. The present name was adopted on March 21, 1958. The taxpayer is engaged primarily in the operation of a motor bus and trackless trolley system in the city of Memphis. Prior to 1945 the taxpayer operated an electric street railway system in the city of Memphis. The latter operation was abandoned in 1945, 1946 and 1947.

2. Plaintiff filed with the Collector of Internal Revenue, Nashville, Tennessee, timely corporation income and excess profits tax returns for the period April 1, 1943 to December 31, 1943, and for the calendar year 1944 and a timely income tax return for the calendar year 1947.

Plaintiff paid income and excess profits taxes and later received refunds of a part of such taxes in the amounts set forth in this finding. Plaintiff filed timely refund claims for the amounts set forth below or, in the alternative, for such greater amounts as are legally refundable.

Period April 1, 1943 to December 31, 1943

	Income Tax	Excess Profits Tax	Total
Paid during 1944	$208,424.78	$757,092.92	$965,517.70
Tentative carryback refund Feb. 20, 1947	132,220.49	(757,092.92)	(624,872.43)
Additional tax paid Dec. 7, 1949	(48,358.77)	114,590.45	66,231.68
Totals	292,286.50	114,590.45	406,876.95
Refund claims timely filed on June 28, 1951, as basis of this action	138,412.13	114,590.45	253,002.58

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Calendar Year 1944

	Income Tax	Excess Profits Tax	Total
Paid during 1945	231,296.55	481,444.74	712,741.29
Tentative carryback refunds:			
Received Feb. 27, 1947	19,030.28	(40,677.24)	(21,646.96)
Received June 12, 1947	228,227.04	(290,542.41)	(62,315.37)
Additional tax paid Dec. 27, 1949..	(85,441.67)	306,366.27	220,924.60
Totals	393,112.20	456,591.36	849,703.56
Refund claims timely filed as basis of this action:			
June 28, 1951	—	—	398,981.36
August 9, 1951	—	456,591.36	456,591.36

Calendar Year 1947

Paid during 1948	56,074.27	—	56,074.27
Paid Dec. 27, 1949	9,235.32	—	9,235.32
Totals	65,309.59	—	65,309.59
Refund claim timely filed May 9, 1951, as basis of this action	37,796.41	—	37,796.41

The timely claims for refund of income and excess profits tax for the periods April 1, 1943 to December 31, 1943, and for the calendar years 1944 and 1947 as listed above were rejected by the Commissioner of Internal Revenue by registered mail on or about April 24, 1957.

3. Plaintiff claims refunds of income and excess profits taxes previously paid for the period April 1, 1943 to December 31, 1943, and for the year 1944, and income tax for the year 1947 on the ground that plaintiff is entitled to:

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(a) losses incurred by plaintiff in 1945, 1946 and 1947 in the abandonment of its street railway system not heretofore allowed to plaintiff;

(b) increases in carrybacks of net operating losses from the year 1945 to the period April 1, 1943 to December 31, 1943, and thereafter to 1944 and from the year 1946 to 1944 as caused by the additional abandonment losses claimed by plaintiff;

(c) inclusions in plaintiff's invested capital of an amount equal to the fair market value of plaintiff's common stock issued for property on December 18, 1905, for the purpose of computing plaintiff's excess profits tax liability for the period April 1, 1943 to December 31, 1943, and the calendar year 1944 and as increasing the excess profits credit carrybacks to the extent allowable from 1945 to the period April 1, 1943 to December 31, 1943, and thereafter to 1944 and from 1946 to 1944. No value for said stock has heretofore been included in plaintiff's invested capital;

(d) increases in plaintiff's excess profits credits brought about by computing plaintiff's earnings and profits as of December 31, 1943, and as of December 31, 1944, after reducing income and excess profits taxes for the period April 1, 1943 to December 31, 1943, and for the calendar year 1944 by giving effect to carrybacks of net operating losses and unused excess profits credits from the years 1945 and 1946. Such reduction of these tax liabilities increases plaintiff's earnings and profits and therefore its equity invested capital and, consequently, reduces its excess profits tax liability for the period April 1, 1943 to

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December 31, 1943, and for the calendar year 1944. No reduction of these tax liabilities as a consequence of giving effect to net operating loss and excess profits credit carrybacks has heretofore been allowed.

4. Plaintiff's books of account have been maintained and its tax returns have been filed for all the periods here involved on an accrual basis.

For the period January 1, 1943 to March 31, 1943, plaintiff's return was included in the consolidated return filed by the National Power & Light Company and subsidiary companies. No issue is here presented as to such return.

Plaintiff's returns for the years 1945 and 1946 as audited by the Internal Revenue Service disclosed a net loss as to each year. The years 1945 and 1946 are relevant to the issues here involved in that the net operating loss and unused excess profits credit carrybacks from said years to the 1943 period and year 1944 are affected by the questions here to be decided.

5. As a result of examinations by revenue agents, the Internal Revenue Service redetermined plaintiff's income and excess profits tax liability for the 1943 period and calendar years 1944 and 1947. As part of such redetermination, the Internal Revenue Service allowed as deductions the losses incurred by plaintiff as a result of abandonment of its street railway system. Said losses were allowed in the amounts and for the years as follows:

1945	$2,344,578.58
1946	1,875,662.87
1947	468,915.72

6. The abandonment losses so incurred included intangible costs found by the Internal Revenue Service as

referable to the abandoned properties and therefore a part of the abandonment losses.

The intangible costs referable to the abandoned properties were determined by the Internal Revenue Service by (a) ascertaining a cost for plaintiff's properties at December 31, 1912; (b) deducting from said cost the portion thereof applicable to physical properties at that date; (c) assigning the remainder of said cost to intangibles; (d) determining that said intangible cost remained unchanged to the years of allowance of the abandonment losses; and (e) that 75 percent thereof was attributable to the abandoned railway properties.

7. For the purpose of computing the abandonment losses in the manner described, the total cost of plaintiff's properties was established by the Internal Revenue Service in the amount of $9,843,000. Said cost was determined as equivalent to the principal amount of plaintiff's bonds outstanding at December 31, 1912, of $9,343,000 plus $500,000 in cash originally paid on plaintiff's common stock upon its organization. This amount did not include any cost attributable to the 25,000 shares of plaintiff's common stock which it is stipulated were issued in part consideration for street railway properties acquired by plaintiff in 1905 from the Extension Company and which properties were included with those for which abandonment losses were allowed for 1945, 1946, and 1947.

8. On or about February 22, 1905, the Extension Company received a franchise from the legislative council of the city of Memphis to construct, operate and maintain a street railway system over certain streets in the city

of Memphis, representing approximately 39 extensions of plaintiff's system. Acting under the authority granted in said franchise, the Extension Company entered into an engineering contract with Ford, Bacon & Davis, as a result of which 14.9 miles of electric railway lines were constructed prior to December 18, 1905, consisting of 27 extensions to plaintiff's system. The lines so constructed connected with lines which were owned and operated by plaintiff. During this period the Extension Company also acquired cars, powerhouse equipment, carhouses, buildings, fixtures and miscellaneous equipment required for the operation of the railway lines constructed by it.

9. The Extension Company maintained its own corporate minutes, stock certificate books and books of account. It made purchases of construction materials and borrowed money for its own account. Meetings of the directors and stockholders were held. As of December 18, 1905, the books of the company showed the following balances in asset accounts:

Reconstruction	$152,564.34
Construction	496,128.73
Accounts receivable	756.67
Stores	50,429.77
Freight and handling	120.49
Total	700,000.00

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Subsidiary records showed that "reconstruction" and "construction" totaling $648,693.07 consisted of the following balances;-

Engineering and superintendence	$ 36,000.36
Right-of-way	500.00
Track and roadway	328,164.41
Electric line	45,222.33
Building and fixtures	4,863.05
Powerhouse equipment	17,377.55
Carhouse and shops, building and fixtures	3,414.87
Cars	105,835.76
Electric equipment of cars	72,042.99
Miscellaneous equipment	5,802.28
Interest and discount	10,255.92
Miscellaneous	1,077.87
Office expense	8,829.09
Tools	9,306.59
Total	648,693.07

The Extension Company had no asset accounts on its books for its franchise to construct, operate and maintain street railway lines in the city of Memphis or for other intangibles. As of December 18, 1905, the Extension Company had realized no receipts from operations.

10. When the Extension Company was incorporated on or about February 21, 1905, it issued 500 shares of common stock, of which 496 were issued to W. S. McCrea who was a secretary and director of plaintiff. McCrea resigned from plaintiff's employ on March 4, 1905. At that time he assigned his 496 shares of the Extension Company to Ford, Bacon & Davis. The other shareholders, Frank G. Jones, Robert L. Benson, James F. Meagher and Edward J. Karr also made transfers of the single shares held by each. On

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December 18, 1905, the Extension Company's stock was held as follows: Isidore Newman & Sons, 495 shares; A. H. Ford, E. W. Ford, E. A. Neugass, L. K. Thompson and R. L. Crump, 1 share each.

11. On February 21, 1905, when the Extension Company was organized, the following were the stockholders of record of plaintiff:

	Shares
C. K. G. Billings	3,331
Frank G. Jones	1,666
W. S. McCrea	1
Robert L. Benson	1
C. H. Ruddock	1
Total	5,000

On March 4, 1905, all of the outstanding shares of plaintiff's capital stock were assigned to Isidore Newman & Sons, Trustees, by the then holders of said shares, C. K. G. Billings, 3,330 shares; Frank G. Jones, 1,666 shares; and W. S. McCrea, Robert L. Benson, James E. Meagher and E. J. Karr, 1 share each.

On December 18, 1905, the date upon which the Extension Company entered into a contract to transfer all of its properties to plaintiff, the stock of plaintiff was held in the amount of 1 share each by 11 individuals and 4,989 shares by Isidore Newman & Sons, Trustees.

12. The Extension Company entered into a contract with plaintiff on December 18, 1905, under which it agreed to sell to plaintiff "all its property, real, personal and mixed, and its franchises, immunities, rights and privileges, with the exception of its franchise or right to be a cor-

poration." The transfer of these properties was to be free and clear of all indebtedness except for the outstanding liability of the Extension Company to pay $650,000 of its promissory notes held by Isidore Newman & Sons which the Extension Company agreed to pay upon receipt of the purchase price from plaintiff. The purchase price agreed upon was 25,000 shares of plaintiff's common stock in the aggregate amount of $2,500,000 par value and $700,000 principal amount of plaintiff's Consolidated Mortgage 5 Percent Gold Bonds. The contract was carried out according to its terms.

13. Before entering into the contract referred to above, plaintiff had no outstanding preferred stock and only 5,000 shares of common. Plaintiff's stockholders, however, on December 18, 1905, authorized 25,000 shares of preferred stock and approved an exchange whereby the old common was retired and the holders thereof were issued 25,000 shares of the new preferred stock having a par value of $100 per share. At the same time the plaintiff's stockholders approved the issuance of 25,000 shares of new $100 par value common stock to the Extension Company together with the $700,000 in Consolidated Mortgage 5 Percent Gold Bonds in exchange for its assets as mentioned above.

14. There is no evidence of any sales of plaintiff's old common stock prior to its cancellation December 18, 1905, and the newly issued common stock was not distributed until December 31, 1905.

During 1906 the market price ranged from a high of $73 in January to about $63 late in the year on small

trades. The Memphis Commercial Appeal quoted bid (over-the-counter) and asked prices of $71 bid and $72 asked in January to $64 bid and $66 asked in December 1906. The Commercial & Financial Chronicle of New York quoted bid and asked prices of plaintiff's common stock from March through November 1906 at $69 bid and $69.75 asked in March to $64 asked in August 1906 and $62 bid in November. There was a gradual deterioration in price of these shares throughout the year of 1906 within a range of about $10. No sales were listed in the two newspapers quoted above.

The plaintiff's common stock was traded on the New Orleans Stock Exchange and the bid and asked prices, as well as sales, were reported in The Daily Picayune of New Orleans. Sales during the year 1906 were consummated in 42 transactions, totaling 1,538 shares at an average price of $67.15. The largest transactions were 200 shares sold January 19, 1906, at $69.75 per share and 163 shares sold June 14, 1906, at $68.50 per share. The average bid and asked prices for the first 3 months of 1906 follow:

	Bid		Asked	
	Days	Average Price	Days	Average Price
January	21	$71.14	19	$72.55
February	22	70.43	14	71.66
March	27	68.96	20	69.89

The fair market value of the 25,000 shares of common stock issued by plaintiff on December 18, 1905, was reasonably $1,750,000, or $70 per share.

15. One of plaintiff's contentions in this case is that, for the purpose of ascertaining plaintiff's obsolescence

and abandonment losses for the years 1945, 1946 and 1947, the plaintiff is entitled to an additional amount of loss based on the cost to plaintiff of property acquired in exchange for the 25,000 shares of its common stock issued on December 18, 1905, in part consideration for the properties acquired from the Extension Company. Defendant denies that additional loss should be allowed on this ground. To resolve this issue the parties have stipulated that if the court should find that the 25,000 shares were issued in part consideration for properties acquired from the Extension Company and if the court should find those shares had a fair market value, then:

(a) the total cost basis of plaintiff's properties at December 31, 1912, which was found by the Internal Revenue Service to be $9,843,000 would be increased by the fair market value of the 25,000 shares of stock;

(b) the cost of that part of plaintiff's properties attributable to intangibles would be an amount determined by deducting from the amount determined in subparagraph (a) above, the amount of $7,385,390.80, the latter being the cost of physical properties of plaintiff included in the total cost of $9,843,000;

(c) the total obsolescence losses allowed for the years 1945, 1946 and 1947 would include 75 percent of the cost attributable to intangible costs determined as stated in subparagraph (b) of this paragraph in lieu of the amount of intangible costs previously allowed by the Internal Revenue Service;

(d) recomputation of the obsolescence losses with respect to the abandonment of plaintiff's street railway

operations in the recomputation of plaintiff's tax liability for the period April 1, 1943 to December 31, 1943, and the calendar years 1944 and 1947, and plaintiff's net loss for the calendar years 1945 and 1946 would be made in accordance with the facts as determined in subparagraphs (a), (b) and (c) of this paragraph.

16. In accordance with the stipulation as set forth in the finding above, the determination of the additional abandonment losses allowable to plaintiff is explained and would be computed as here and subsequently indicated. The additional cost of $1,750,000 when added to the cost of plaintiff's properties at December 31, 1912,[1] of $9,843,000, as previously determined by the Internal Revenue Service, establishes an adjusted total cost for said properties at that date of $11,593,000. The effect of this adjusted cost upon the amount of allowable abandonment losses may be ascertained by applying the method of calculating such loss as shown by the revenue agent's report wherein determination of the abandonment losses was originally shown.

17. The loss with respect to the property abandoned was originally determined by the Internal Revenue Service in an engineering study prepared by Engineer Revenue Agent Karl Schmitt in a report dated October 23, 1946. The agent found that the cost of plaintiff's properties, both tangible and intangible, as of December 12, 1912, was

[1] The date of December 31, 1912, has been used for the purpose of ascertaining the cost attributable to intangibles included in the total cost basis of plaintiff's property, since subsequent to that date and up to the abandonment of plaintiff's street railway lines and operations no change has occurred with respect to such intangible costs.

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$9,843,000 which was equivalent to the sum of plaintiff's then outstanding bonds and cash originally paid for plaintiff's stock. The agent allocated the sum of $9,843,000 between tangible and intangible property as shown by the following table which is quoted from Agent Schmitt's report:

Railway property—depreciable		$5,739,209.62
Electric power plant (sold in 1923):		
Power plant buildings	$254,705.94	
Power plant equipment	615,937.17	
		870,643.11
Non-depreciable:		
Land	135,581.00	
Right-of-way	26,838.00	
Grading	230,856.28	
Law expenditures	29,424.04	
Misc. before construction begins	332,126.28	
Total cost of non-depreciable property	(760,825.60)	[2] 775,538.07
Total cost of classified property		7,385,390.80
Cash cost or equivalent of property 12/31/12		9,843,000.00
Total classified cost		7,385,390.80
Cost attributable to intangibles		2,457,609.20

[2] The error of $14,712.47 in the amount carried into the total is not explained in the revenue agent's report.

Upon ascertaining the cost attributable to intangibles in the sum of $2,457,609.20 as shown, the agent made a further determination that 75 percent of said intangible cost, or $1,843,206.90, was attributable to the abandoned properties at December 31, 1944.

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Revenue Agent Schmitt determined the cost of plaintiff's property on hand December 31, 1944, for which abandonment losses would be allowed in the years 1945, 1946 and 1947, as set forth in the following table and quoted from his report:

Railway property to be removed:	
Depreciable property	$4,000,069.97
Non-depreciables classified	384,730.17
Intangible cost (75 percent)	1,843,206.90
Total cost of properties	6,228,007.04
Less depreciation reserve	1,941,372.67
Cost remaining at December 31, 1944	4,286,634.37

Revenue Agent Schmitt stated that the above amount was subject to adjustment to reflect removal and paving costs less salvage. It has been stipulated by the parties that no part of the intangible costs included in "railway property to be removed" had been allowed as a deduction for Federal income tax purposes prior to December 31, 1944, either by way of depreciation, amortization or otherwise. It has been further stipulated by the parties that there was no change in intangible costs during the period December 31, 1912 to December 31, 1944.

18. The loss as computed by Revenue Agent Schmitt was adjusted by the Internal Revenue Service on audit of plaintiff's tax returns for the period April 1, 1943 to December 31, 1943, and for the calendar years 1944, 1945, 1946 and 1947 in determining the amount of the obsolescence and abandonment losses to be allowed. The following adjustment is taken from the examining agent's

report dated June 20, 1949, for the years 1943 through 1947 at page 47 of such report:

Value of property abandoned, net, at 12/31/44 revaluation report dated 10/23/46		$4,286,634.37
Add removal and other related costs less salvage recovered		546,882.71
Total loss before further adjustment		4,833,517.08
Reduction per report dated 9/13/48		$ 144,359.91
Total loss adjusted		4,689,157.17
Allocation to years:		
1945 (1/2)	$2,344,578.58	
1946 (4/10)	1,875,662.87	
1947, (1/10)	468,915.72	
		4,689,157.17

The losses previously allowed by the Internal Revenue Service for the years 1945, 1946 and 1947 were the amounts allocated by the examining agent to such years as quoted above from his report, i.e., 1945, $2,344,578.58; 1946, $1,875,662.87; and 1947, $468,915.72.

19. The amounts of losses as shown were allowed and were reflected in redetermination of plaintiff's tax liabilities for the 1943 period and years 1944 and 1947. Amounts of additional tax or refunds, as the case may be, as a result of such redetermination were respectively paid or refunded as shown in finding 2, and the refunded claims herein issue are the sole remaining claims in adjustments with respect to such liabilities.

20. Applying the method of loss determination as shown by the agents' reports, the adjusted amounts of

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abandonment losses allowable for the years 1945, 1946 and 1947 are established as follows:

Corrected cost of plaintiff's property at December 31, 1912		$11,593,000.00
Total cost of classified property as shown by agent's report		7,385,390.80
Cost attributable to intangibles		4,207,609.20
75 percent attributable to abandoned property		3,155,706.90
Railway property to be removed:		
Depreciable property		4,000,069.97
Non-depreciable property		384,730.17
Intangible cost (75%) as corrected		3,155,706.90
Total cost of properties abandoned		7,540,507.04
Less: depreciation reserve applicable to above depreciable property		1,941,372.67
Cost remaining at December 31, 1944		5,599,134.37
Giving effect to the adjustments to the above cost as shown by the examining agent's report dated June 20, 1949.		
Add: removal and other related costs less salvage recovered		$ 546,882.71
		6,146,017.08
Reduction per report dated 9/13/48		144,359.91
Total loss adjusted		6,001,657.17
Allocation to years:		
1945 (½)	$3,000,828.58	
1946 (4/10)	2,400,662.87	
1947 (1/10)	600,165.72	
		6,001,657.17

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21. Additional deductions, as adjusted in the foregoing findings, would apply to the following taxable years:

	Additional deductions as adjusted above
1945	$ 656,250.00
1946	525,000.00
1947	131,250.00
Total	1,312,500.00

22. Plaintiff's excess profits tax liabilities for the period April 1, 1943 to December 31, 1943, and the calendar year 1944 were calculated by application of an excess profits credit based on plaintiff's invested capital under the provisions of section 718 and related sections of the Internal Revenue Code of 1939. Upon audit by the Internal Revenue Service plaintiff was allowed an unused excess profits credit carryback from the calendar year 1945 to the period April 1, 1943 to December 31, 1943, and an unused excess profits credit carryback from the calendar year 1946 to the calendar year 1944. These excess profits credit carrybacks were likewise calculated on the basis of a determination of plaintiff's invested capital under the provisions of section 718 and related sections of the Internal Revenue Code of 1939. The portion of plaintiff's equity invested capital attributable to money and property paid for capital stock has been established by the Internal Revenue Service to be $5,662,316.44 for the period ended December 31, 1943, and for the calendar years 1944, 1945 and 1946. In the determination of this sum, no amount was included for the 25,000 shares of plaintiff's common stock issued on or about December 18, 1905, to the Extension Company.

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23. Accumulated earnings and profits at the beginning of the taxable year are includible in invested capital for the purpose of calculating the excess profits credit for that year and the unused excess profits credit carryback. The plaintiff's tax liability for the 1943 period here involved, on the basis of which plaintiff made payment of additional tax during 1949 as shown above, was determined in a revenue agent's report dated June 20, 1949. Exhibit L-1, page 69, of that report states that the amount of plaintiff's tax liability for the 1943 period and year 1944 used in computing the net additions to accumulated earnings for such years does not take into account the reduction of that liability which has occurred through applying the net operating loss and unused excess profits credit carrybacks. These carrybacks arose in the loss years 1945 and 1946 and were carried back to the 1943 period and year 1944 in computing the tax liability for such years.

24. Plaintiff contends that its actual tax liability as finally determined should be used in computing the earnings and profits for the 2 taxable years stated. Defendant denies this contention. If this court should find for plaintiff on this issue, the amount of accumulated earnings and profits includible in computing plaintiff's invested capital, and hence its excess profits credits, will be calculated by using plaintiff's ultimate tax liability for the 1943 period and year 1944 to be determined under 38(c) of the rules of the court in giving effect to the findings in this proceeding.

25. It is plaintiff's contention that for the purpose of determining its equity invested capital for the period ended December 31, 1943, and for the calendar years 1944,

1945 and 1946, in order to ascertain taxpayer's excess profits tax liability for the period ended December 31, 1943, and for the calendar year 1944, there should be added to the sum of $5,662,316.44, plaintiff's equity invested capital as determined by the Internal Revenue Service, an amount as to property paid for stock issued by plaintiff equivalent to the fair market value of the 25,000 shares of plaintiff's common stock issued on or about December 18, 1905, in part consideration for the properties of the Extension Company.

For the purpose of resolving this issue, plaintiff and defendant have stipulated that (a) if this court should find that said 25,000 shares of plaintiff's common stock were issued on December 18, 1905, in part consideration for the properties acquired from the Extension Company, and (b) if this court should find that such stock had a fair market value, then and in such event the portion of plaintiff's equity invested capital referable to capital stock would be the sum of $5,662,316.44 plus said fair market value.

ULTIMATE FINDINGS

26. In finding 14 it was determined that the fair market value of plaintiff's new common stock authorized December 18, 1905, was reasonably $70 per share. There is no satisfactory evidence that the 25,000 shares of plaintiff's common stock issued to the Extension Company were truly a part of the consideration for the assets acquired by plaintiff through an indenture and conveyance by the Extension Company to the plaintiff dated December 18, 1905.

The true stockowners of the plaintiff company and the Extension Company at December 18, 1905, when the trans-

actions occurred, are not determinable from the evidence. It is reasonable to conclude that they were identical (see findings 10 and 11). When the Extension Company was organized on February 21, 1905, it issued 500 shares of capital stock, of which 496 shares were issued to W. S. McCrea, plaintiff's secretary and a director, obviously the "straw man" or nonentity.

27. The cost of improvements, and certain equipment for exploiting the franchise issued to the Extension Company, was financed through Isidore Newman & Sons of New York on notes issued to them by the plaintiff company. The plaintiff, in turn, received and held notes for like amounts as evidence of indebtedness of the Extension Company. By December 18, 1905, the Extension Company's improvement costs amounted to $700,000, including capitalized expenses for interest and discount of $10,255.92, office expense of $8,829.09 and freight and handling of $120.49.

28. On December 18, 1905, when all of the pertinent transactions were approved and made effective, including the conveyance of the property by the Extension Company to the plaintiff, the finance company, Isidore Newman & Sons, held 495 shares of the capital stock of the Extension Company, representing 99 percent thereof. One share each was held by five other individuals. At the same time Isidore Newman & Sons, as trustees, held 4,989 shares of the old common stock of the plaintiff, or 99.78 percent thereof, and 1 share each was held by 11 other individuals.

On December 18, 1905, the plaintiff company's stockholders authorized the issuance of 25,000 shares preferred

stock, 25,000 shares of common stock and $10,000,000 of 5 percent bonds and, by mutual agreement between the parties concerned, all of the following transactions were consummated as of that date: (a) Isidore Newman & Sons cancelled and surrendered plaintiff's notes amounting to $650,000 and accepted in lieu thereof the Extension Company's notes in like amount; (b) plaintiff issued $700,000 in bonds and 25,000 shares of its common stock to the Extension Company; (c) the Extension Company conveyed all of its assets and liabilities, having a net book value of $700,000, other than the $650,000 in notes, to the plaintiff; (d) the Extension Company transferred and conveyed to Isidore Newman & Sons the $700,000 in bonds issued by the plaintiff in exchange for the $650,000 in notes, thereby cancelling its remaining liabilities; (e) the Extension Company then approved the distribution to its own stockholders of the 25,000 shares of plaintiff's common stock with the provision "that each stockholder be entitled to receive his equal pro rata share of said securities, but that each stockholder may assign such right to such person, firm or corporation as he may, by an order in writing, designate." Considering all of the evidence in this case, it is reasonable to conclude that the stockholders of the Extension Company and the plaintiff were identical and that 25,000 shares of plaintiff's common stock were indirectly paid to plaintiff's own stockholders.

29. By the foregoing transactions the Extension Company liquidated all of its assets and liabilities. It had

never established an evaluation of its franchise on its own books. There is no evidence that the plaintiff had established or determined any value for the franchise acquired from the Extension Company on December 18, 1905. There is no evidence that the plaintiff's earnings were sufficiently increased after the acquisition of the additional franchise and other assets from the Extension Company whereby a reasonable determination of the value of such franchise might be made. The plaintiff's annual earnings for the calendar years 1904 through 1908, and its bonded indebtedness at December 31, 1905, through 1908, are reflected in the following tabulation:

	Net earnings	Bonded indebtedness
1904	$184,281	
1905	187,998	$5,700,000
1906	247,925	7,400,000
1907	192,411	8,000,000
1908	171,559	8,083,000

30. The Extension Company had not fully developed its franchise and had never operated any part of it. There is no evidence that the Extension Company had ever intended to operate its franchise or that it could have been operated profitably, except as an adjunct of the plaintiff's system.

It is reasonable to conclude that the $700,000 of 5 per cent bonds issued by the plaintiff as of December 18, 1905, represented the fair and reasonable net value of all assets acquired by the plaintiff from the Extension Company and that no consideration can be reasonably attri-

butable to the 25,000 shares of its common stock as a part of the consideration of such assets, as set forth in the proposed agreement of December 18, 1905, by the Extension Company. The final agreement between the plaintiff and the Extension Company has not been furnished in evidence.

Conclusion of Law

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiff is not entitled to recover, and the petition is, therefore, dismissed.

APPENDIX B

Stipulation of Facts Filed With the United States Court of Claims in Petitioner's Case

IN THE
UNITED STATES COURT OF CLAIMS
No. 355-57

MEMPHIS TRANSIT COMPANY,
Plaintiff,

versus

THE UNITED STATES,
Defendant.

STIPULATION OF FACTS

IT IS HEREBY STIPULATED AND AGREED by and between the parties hereto, by their respective counsels, that the facts hereinafter stated shall be taken as true, provided however that this stipulation shall be without prejudice to the right of either party to introduce upon the trial of this action any other and further evidence not inconsistent with the facts herein stipulated, and further reserving to either party the right to object to any fact herein stipulated on the ground that such fact is irrelevant or immaterial:

1. The first claim arises under the Internal Revenue laws of the United States and more particularly Sections 23, 113 and 718 of the Internal Revenue Code of 1939. The second claim arises under the Internal Revenue laws

of the United States and more particularly Sections 23, 113 and 718 of the Internal Revenue Code of 1939. The third claim arises under the Internal Revenue laws of the United States and more particularly Sections 23 and 113 of the Internal Revenue Code of 1939.

2. The jurisdiction of this Court is based upon Title 28, United States Code, Section 1491, in that these claims against the United States are founded upon an Act of Congress.

3. No action upon the claims, other than as set forth in the petition, has been taken by plaintiff before the Congress or any of the departments of the United States or in any court and no assignment or transfer of said claims or any part thereof has been made by plaintiff.

4. At all times hereinafter mentioned plaintiff was, and now is, a corporation duly organized and existing under and by virtue of the laws of the State of Tennessee, having been incorporated on March 28, 1895, with offices at 821 Beale Avenue, Memphis 1, Tennessee. Formerly the plaintiff's corporate name was The Memphis Street Railway Company; this name was changed to Memphis Transit Company pursuant to a resolution duly adopted by the stockholders of the plaintiff on March 21, 1958.

5. Plaintiff is engaged primarily in the operation of a motor bus and trackless trolley system in the City of Memphis. Prior to 1945 plaintiff was engaged primarily in the operation of an electric street railway system in the City of Memphis.

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6. During the period February 22, 1905 to December 18, 1905, the plaintiff was in the business of operating a street railway over the lines owned by it in the City of Memphis.

7. The Memphis Street Railway Extension Company (hereinafter sometimes referred to as "Extension Company") was a corporation duly organized and existing under the laws of the State of Tennessee, having been incorporated on or about February 21, 1905.

8. The original subscribers to the stock of Extension Company were as follows:

W. S. McCrea	496 shares
Frank G. Jones	1 share
Robert L. Benson	1 share
James F. Meagher	1 share
Edward J. Karr	1 share
Total	500 shares

W. S. McCrea had been associated with the affairs of the plaintiff for a period of approximately five years prior to the incorporation of Extension Company. He was elected a director of the plaintiff on January 26, 1899 and as Secretary of the plaintiff on April 24, 1899. He continued to serve in these capacities until his resignation on March 4, 1905.

Under date of March 4, 1905, W. S. McCrea assigned 496 shares of Extension Company capital stock held by him to Ford, Bacon & Davis as evidenced by photostatic copy of said assignment attached hereto as Exhibit A. Said assignment appears on page 27 of the corporate minute book of Extension Company. During the period

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March 5, 1905 to December 18, 1905, the date upon which Extension Company entered into a contract to transfer all of its properties to the plaintiff, there were various transfers of stock so that on December 18, 1905 the holders of record were as follows:

Isidore Newman & Sons	495 shares
A. H. Ford	1 share
E. W. Ford	1 share
E. A. Neugass	1 share
L. K. Thompson	1 share
R. L. Crump	1 share
Total	500 shares

9. At the time of the organization of Extension Company on or about February 21, 1905, the following were the stockholders of record of plaintiff:

C. K. G. Billings	3,331 shares
Frank G. Jones	1,666 shares
W. S. McCrea	1 share
Robert L. Benson	1 share
C. H. Ruddock	1 share
Total	5,000 shares

Under date of March 4, 1905, the then total outstanding 5,000 shares of plaintiff's capital stock were assigned to Isidore Newman & Sons, Trustees by the following then holders of said shares:

C. K. G. Billings	3,330 shares
Frank G. Jones	1,666 shares
W. S. McCrea	1 share
Robert L. Benson	1 share
James F. Meagher	1 share
E. J. Karr	1 share
Total	5,000 shares

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A photostatic copy of said assignment is attached hereto as Exhibit B. Said assignment is attached to The Memphis Street Railway Company stock certificate No. 18 in said company's stock certificate book. During the period March 5, 1905 to December 18, 1905, the date upon which Extension Company entered into a contract to transfer all of its properties to plaintiff, there were various transfers of plaintiff's stock so that on December 18, 1905 plaintiff's stock was owned by the following holders:

Isidore Newman & Sons, Trustees	4,989 shares
T. H. Tutweiler	1 share
W. B. Rogers	1 share
J. H. Watkins	1 share
J. R. Pepper	1 share
W. B. Brockway	1 share
T. M. R. Meikleham	1 share
Henry P. Dart	1 share
Jos. H. Thompson	1 share
W. B. Yereance	1 share
E. E. Vreeland	1 share
W. B. Mallory	1 share
Total	5,000 shares

10. On or about February 22, 1905, Extension Company received a franchise from the Legislative Council of the City of Memphis to construct, operate and maintain a street railway system over certain streets in the City of Memphis. Acting under the authority granted in said franchise, Extension Company entered into an engineering contract with Ford, Bacon & Davis as result of which approximately fifteen miles of railway lines were con-

structed prior to December 18, 1905. The lines so constructed are shown on the map hereto attached as Exhibit C. The location of said lines in the City of Memphis and environs is shown on the statement attached as Exhibit D. A photostatic copy of the minutes of the directors' meeting of Extension Company held May 11, 1905 authorizing said contract with Ford, Bacon & Davis is attached hereto as Exhibit D-1. Exhibit D-2 hereto attached is a photostatic copy of page 12 of the construction ledger of Extension Company which shows by months from April 1905 to December 1905 the details of the construction charges for said railway lines. Exhibit D-3 is a photostatic copy of eleven purchase orders issued by Ford, Bacon & Davis acting under said engineering contract and relating to construction of said fifteen miles of railway lines. During the period February 22, 1905 to December 18, 1905, Extension Company was engaged in exercising the franchise granted to it by the City of Memphis, thereby preventing such franchise from lapsing, by the construction of street railway lines in the areas for which its franchises had been granted and in providing the equipment necessary to operate such railways.

11. During the period subsequent to organization of Extension Company and prior to December 18, 1905, Extension Company borrowed $650,000. The circumstances of such borrowing are explained by Journal Entry #6 which appears on page 1 of The Memphis Street Railway

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Company Journal for December 1905 and which entry reads as follows:

"Bills Payable	$650,000	
To Bills Receivable		$650,000

This Company has at various times borrowed money from Isidore Newman & Sons upon promissory notes. It has also loaned money to The Memphis Street Railway Extension Co. upon that company's promissory notes. By an arrangement with Isidore Newman & Sons they take the notes of The Memphis Street Railway Extension Company to this company in payment of and exchange for this company's notes to Isidore Newman & Sons. The exchange is made as of Dec. 18, 1905."

12. In an offer dated December 18, 1905 set forth in the minutes of a meeting of stockholders of Extension Company held on the same date, a true copy of said minutes being hereto attached as Exhibit E, Extension Company offered to convey to plaintiff "all its property, real, personal and mixed, and its franchises, immunities, rights and privileges, with the exception of its franchise or right to be a corporation." These properties are described in detail at Exhibit E-1, which is the minutes of an adjourned special meeting of the board of directors of Extension Company held at 6:00 P.M. on December 18, 1905. The transfer of these properties was to be free and

clear of all indebtedness except for the outstanding liability of Extension Company to pay off $650,000 of its promissory notes which Extension Company agreed to pay upon receipt of the purchase price. In return, plaintiff was to pay a purchase price of 25,000 shares of plaintiff's common capital stock in the aggregate amount of $2,500,000 par value and $700,000 principal amount of plaintiff's Consolidated Mortgage 5% Gold Bonds. Extension Company's offer was approved by plaintiff's stockholders at an adjourned special meeting of said stockholders held December 18, 1905 and was accepted by plaintiff's officers under authority of the directors of plaintiff at a meeting of plaintiff's directors held December 18, 1905. Said agreement was carried out according to its terms as shown by minute of an adjourned special meeting of the board of directors of Extension Company held at 6:00 P.M. December 18, 1905; see Exhibit E-1.

13. On December 18, 1905, the stockholders of plaintiff duly authorized and approved issuance of the following amounts of stock: 25,000 shares of preferred stock having a par value of $100 per share and 25,000 shares of common capital stock having a par value of $100 per share. On December 18, 1905 stockholders of plaintiff duly authorized and approved a transaction thereafter carried out whereby the 5,000 shares of capital stock then outstanding would be retired and the holders of such 5,000 shares of capital stock would be issued 25,000 shares of the new preferred stock having a par value of $100 per share.

14. On December 18, 1905, the plaintiff's stockholders further approved issuance of the 25,000 shares of new

$100 par value common capital stock of the plaintiff to Extension Company as part of the purchase price of Extension Company's properties, and issuance of $700,000 of the Consolidated Mortgage 5% Gold Bonds of the plaintiff to Extension Company for the remainder of such purchase price. This purchase transaction was carried out; see Exhibit E-1.

15. Extension Company maintained its own corporate minutes, stock certificate books and books of account. The corporate minute books contained minutes of stockholders' and directors' meetings from February 21, 1905 through December 18, 1905. The stock certificate book showed nine stock certificates issued, some of which were reissued. The books of account included a construction ledger, an accounts receivable ledger of approximately 21 pages, a cash book, a bound journal, and several typewritten pages containing journal entries which were copies of entries in the bound journal. The records of Extension Company show journal entries in the closing of said books at December 31, 1905, a copy of which is attached hereto as Exhibit F.

16. A cost basis of plaintiff's total properties as at December 31, 1912 has been determined as the sum of $9,843,000 as shown by an Internal Revenue Service Valuation Report dated October 23, 1946 signed by Engineer Revenue Agent Karl Schmitt and approved by S. H. Thompson, Engineer Reviewer, a copy of which is hereto attached as Exhibit G; the properties owned by plaintiff on December 31, 1912 included those acquired by plaintiff from Extension Company as stated in paragraph "13"

hereof but said cost of $9,843,000 does not include any value in respect of the 25,000 shares of plaintiff's common capital stock issued on December 18, 1905.

17. Beginning in 1945 plaintiff embarked upon a program of substituting motor bus and trackless trolley coach operations, herein referred to as motor bus operations, for its street railway operations, and as a result of such program abandoned its street railway lines and operations. Plaintiff completed full substitution of motor bus operations and consequent abandonment of its street railway operations in 1947. Upon abandonment of its street railway lines and operations plaintiff claimed and was allowed by the Commissioner of Internal Revenue an obsolescence loss in respect thereof in the computation of its liability for Federal income and excess profits taxes. Fifty percent of the loss attributable to such abandonment was allowed as an obsolescence loss for the year 1945, forty percent as an obsolescence loss for the year 1946, and ten percent as an obsolescence loss for the year 1947, as shown by Exhibit K of the Revenue Agent's Report dated June 20, 1949 a photostatic copy of which Report is attached hereto as Exhibit H.

18. The abandonment loss referred to in paragraph "17" hereof includes intangible costs attributable to plaintiff's properties no part of which prior to said abandonment had been allowed as a deduction for Federal income tax purposes either by way of depreciation, amortization or otherwise.

19. It has been established and determined that 75% of the intangible costs attributable to plaintiff's properties

is a part of the total cost of plaintiff's properties in respect of which the obsolescence losses arise in the years as stated in paragraph "17" hereof. Such determination is shown in the Internal Revenue Service Valuation Report attached hereto as Exhibit G and also in a subsequent Internal Revenue Service Valuation Report dated November 17, 1947 and September 13, 1948, respectively, each of which reports is attached hereto as Exhibits I and J, respectively.

20. The obsolescence losses in respect of plaintiff's properties including as a part thereof 75% of the intangible costs attributable to said properties were allowed in recomputation of plaintiff's tax liability for the period April 1, 1943 to December 31, 1943, the calendar years 1944 and 1947 and plaintiff's net loss for the calendar years 1945 and 1946, as shown on page 4 of Internal Revenue Service Valuation Report of October 23, 1946 (Exhibit G attached) and the following pages and Exhibit K of Revenue Agent's Report dated June 20, 1949 (Exhibit H attached):

Year 1945—Schedule 16A Exhibit K (of Agent's Report)
Year 1946—Schedule 24A Exhibit K (of Agent's Report)
Year 1947—Schedule 31A Exhibit K (of Agent's Report)

(Note: Year 1946 applicable as part of net operating loss deduction for 1944).

Plaintiff's tax liability for said years has been determined and paid on the basis of its filed returns as changed by said Revenue Agent's Report dated June 20, 1949 (Exhibit H attached) for such years. The amounts of said liability are shown on "Statement of Total Tax Liability" which

is part of said Revenue Agent's Report (First page of Exhibit H attached).

21. For the purpose of the allowance of the obsolescence losses allowed as stated in paragraph "20" hereof the measure of the intangible costs referred to in said paragraph was computed as being the amount by which the total costs of plaintiff's properties determined as at December 31, 1912 exceeded the total cost of such properties attributable solely to tangible physical properties. The Internal Revenue Service Valuation Report referred to in paragraph "16" hereof shows the total of such intangible costs as $2,457,609.20. Said Valuation Report on page 4 thereof determined such intangibles cost as that part of the cost of plaintiff's total properties which remained after deducting from such total cost the portion thereof attributable to physical properties, as follows:

"Cash cost or equivalent of property 12/31/12"	$9,843,000.00
"Total classified cost"	7,385,390.80
"Cost attributable to Intangibles"	$2,457,609.20

Said Valuation Report further determined that such intangibles cost continued applicable as part of the cost of plaintiff's properties at December 31, 1944.

22. The "Cost attributable to Intangibles" referred to in paragraph "21" hereof was determined by ascertaining, first, a total cost basis of plaintiff's properties at December 31, 1912, stated in paragraphs "16" and "21" hereof as the sum of $9,843,000, and, second, the total cost basis of the

physical properties of plaintiff exclusive of any intangible costs at the same date, stated in paragraph "21" hereof as $7,385,390.80. The amount of "Cost attributable to Intangibles" was then ascertained by deducting said total cost basis of physical properties from the total cost basis of plaintiff's properties.

23. As stated in paragraph "16" hereof, since the total of $9,843,000 stated as the total cost basis of plaintiff's properties at December 31, 1912 does not include any value in respect of the 25,000 shares of plaintiff's common capital stock issued on December 18, 1905, which properties are included with those owned by plaintiff at December 31, 1912, if this Court should find that said 25,000 shares of the plaintiff's common capital stock were issued on December 18, 1905 in part consideration for the properties acquired from Extension Company, and if this Court should find that such stock had a fair market value then and in such event the total cost of plaintiff's properties at December 31, 1912 would be the sum of $9,843,000 plus said fair market value.

24. The date of December 31, 1912 has been used for the purpose of ascertaining the cost attributable to intangibles included in the total cost basis of plaintiff's property since subsequent to that date and up to the abandonment of plaintiff's street railway lines and operations as stated in paragraph "17" hereof no change has occurred in respect of such intangible costs.

25. If this Court should find that said 25,000 shares of the plaintiff's common capital stock were issued on December 18, 1905 in part consideration for the properties

acquired from Extension Company, and if this Court should find that said 25,000 shares of plaintiff's common capital stock issued on December 18, 1905 had a fair market value then and in such event:

(a) The total cost basis of plaintiff's properties at December 31, 1912 would be an amount determined as stated in paragraph "23" hereof.

(b) The cost of that part of plaintiff's properties attributable to intangibles would be an amount determined by deducting from the amount determined in subparagraph "a" of this paragraph the amount of $7,385,390.80 the latter being the cost of physical properties of plaintiff as stated in paragraph "21" hereof.

(c) The total obsolescence loss allowed for the years 1945, 1946 and 1947 would include 75% of the costs attributable to intangible costs determined as stated in subparagraph "b" of this paragraph in lieu of the amount of intangibles costs previously allowed by the Internal Revenue Service in the computation of such obsolescence loss as stated in paragraph "21" hereof.

(d) Recomputation of the obsolescence loss in respect of the abandonment of plaintiff's street railway operations in the recomputation of plaintiff's tax liability for period April 1, 1943 to December 21, 1943, the calendar years 1944 and 1947 and plaintiff's net loss for the calendar years 1945 and 1946 would be made in accordance with the facts as determined in subparagraphs "a", "b" and "c" of this paragraph.

26. Plaintiffs excess profits tax liability for the period April 1, 1943 to December 31, 1943 and the calendar year

1944 was calculated by application of an excess profits credit arising from determination of plaintiff's invested capital under the provisions of Section 718 and related sections of the Internal Revenue Code 1939.

27. The portion of plaintiff's equity invested capital referable to capital stock has been established in the sum of $5,662,316.44 for the period ended December 31, 1943, the calendar years 1944, 1945 and 1946 as shown by Schedule 5, 12, 20 and 28 respectively of the Revenue Agent's Report dated June 20, 1949 attached hereto as Exhibit H. In the determination of said amount, no amount was included therein in respect of the 25,000 shares of plaintiff's common capital stock issued on or about December 18, 1905 to the Extension Company.

28. If this Court should find that said 25,000 shares of plaintiff's common capital stock were issued on December 18, 1905 in part consideration for the properties acquired from Extension Company, and if this Court should find that such stock had a fair market value then and in such event the portion of plaintiff's equity invested capital referable to capital stock would be the sum of $5,662,316.44 plus said fair market value.

29. The record of bid and asked prices and sales of plaintiff's common stock on the New Orleans Stock Exchange as published in "The Daily Picayune", a newspaper of New Orleans, Louisiana, for the period January 6, 1906 to January 6, 1907 is shown by the statement hereto attached and made part hereof as Exhibit K.

30. Attached hereto and made part hereof as Exhibit L is a photostatic copy of a letter dated December 8, 1953

addressed to plaintiff's treasurer by a vice president of Union Planters National Bank, Memphis, Tennessee, containing information relating to market quotations in respect of plaintiff's common stock.

31. The record of bid and asked prices of plaintiff's common stock as indicated by quotations thereof published in the "Memphis Commercial Appeal", a newspaper of Memphis, Tennessee, for the months of January 1906 to December 1906, inclusive, is shown on the statement hereto attached and made part hereof as Exhibit M.

32. The record of bid and asked prices of plaintiff's common stock as indicated by quotations thereof published in the "Commercial & Financial Chronicle", a New York newspaper, for the months of March 1906 to December 1906, inclusive, is shown on the statement hereto attached and made part hereof as Exhibit N.

33. Attached hereto as Exhibit O is a statement copied from text which appears at pages 1060 and 1061 of Moody's Manual of Railroads and Corporation Securities for the year 1907. Such statement shows that American Cities Railway & Light Company, a holding company, had acquired during 1906 $2,153,500 par value of plaintiff's common stock on an exchange basis of $108 par value of American Cities Railway & Light Company common stock for each $100 par value of plaintiff's common stock.

34. Attached hereto as Exhibit P are photostatic copies of a record of the New Orleans Stock Exchange which show the shares of stock of American Cities Railway & Light Company traded during 1906 on the New Orleans Stock Exchange and the price at which said shares were sold.

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35. A summary of the gross revenues, expenses and net income of plaintiff for the five year period 1904 to 1908, inclusive, is shown on the statement hereto attached as Exhibit Q.

36. A copy of the balance sheets of plaintiff as at December 31, 1905 to 1908, inclusive, is attached hereto as Exhibit R.

37. In the computation of plaintiff's adjusted excess profits tax net income for the period April 1, 1943 to December 31, 1943 determined after application of net operating loss carryback applicable to such period the Commissioner of Internal Revenue through his examining agent increased plaintiff's excess profits net income for said period, as shown by Schedules Nos. 4 and 7 of the Revenue Agent's Report dated June 20, 1949 (Exhibit H attached), by multiplying the excess profits net income by three hundred and sixty-five and dividing the amount thus calculated by two hundred and seventy-five, said result being referred to in Schedule No. 7 of the Revenue Agent's Report as "excess profits net income annualized".

38. Plaintiff filed a corporation income tax return and an excess profits tax return for the period April 1, 1943 to December 31, 1943 with the Collector of Internal Revenue, Nashville, Tennessee. Said returns indicated an income tax liability of $208,424.78 and an excess profits tax liability of $757,092.92, or a total liability of $965,517.70. This total tax was paid to said Collector in installments as follows: $190,000.00 on or about March 15, 1944; $190,000.00 on or about June 15, 1944; $344,138.28 on or about September 15, 1944 and $241,379.42 on or about December 15, 1944.

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39. Subsequent to the filing of the income and excess profits tax returns for the period April 1, 1943 to December 31, 1943, plaintiff received tentative carry-back refunds in the amount of $624,872.43 by a check dated February 20, 1947. This amount was the difference between an excess profits tax overassessment in the amount of $757,092.92 and an assessed deficiency of income tax in the amount of $132,220.49.

40. A Revenue Agent's Report dated June 20, 1949 (Exhibit H) indicated an overassessment of income tax in the amount of $48,358.77 and an additional excess profits tax in the amount of $114,590.45 for the period April 1, 1943 to December 31, 1943, or a net deficiency of $66,231.68.

41. On or about December 27, 1949, plaintiff paid $66,231.68 to the Collector of Internal Revenue, Nashville, Tennessee. Said payment discharged plaintiff's liability for the net tax deficiency indicated in the aforesaid Revenue Agent's Report for the period April 1, 1943 to December 31, 1943.

42. With respect to the period April 1, 1943 to December 31, 1943, prior to the expiration of the period of limitation upon assessment of additional income and excess profits taxes for said period, consents executed by plaintiff and accepted by the Commissioner of Internal Revenue were filed extending the period of limitation upon assessments for said period to December 31, 1950.

43. On or about June 28, 1951, within the period of limitation prescribed by Section 322(b)(1) of the Internal Revenue Code of 1939, plaintiff filed with the Collector of

Internal Revenue, Nashville, Tennessee, a claim for refund of the sum of $253,002.58 or such greater amount including interest as is legally refundable with respect to the period April 1, 1943 to December 31, 1943. Said sum of $253,002.58 consisted of $138,412.13 of income taxes and $114,590.45 of excess profits taxes claimed to have been overpaid by plaintiff.

44. The Collector of Internal Revenue at Nashville, Tennessee, in a letter addressed to plaintiff under date of August 1, 1951 acknowledged receipt on June 28, 1951 of the claim for refund referred to in paragraph "43" hereof. A photostatic copy of said letter is hereto attached as Exhibit S.

45. On or about August 9, 1951, pursuant to a written request dated August 1, 1951, from the Collector of Internal Revenue, Nashville, Tennessee, for separate claims for each type of tax—one for income tax and one for excess profits tax—plaintiff filed with said Collector two supplementary claims with respect to the period April 1, 1943 to December 31, 1943. In one of these supplementary claims plaintiff demanded a refund of income taxes in the amount of $138,412.13 or such greater amount including interest as is legally refundable. In the other of these supplementary claims plaintiff demanded a refund of excess profits taxes in the amount of $114,590.45 or such greater amount including interest as is legally refundable. Plaintiff also returned to said Collector the claim originally filed with him on June 28, 1951 as stated in paragraph "43" hereof. A photostatic copy of a true copy of plaintiff's letter of transmittal of said claims to the Collector is hereto attached as Exhibit T.

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46. On or about April 24, 1957, the Commissioner of Internal Revenue notified The Memphis Street Railway Company by registered mail of the rejection and disallowance of all of the aforesaid claims for refund with respect to the period April 1, 1943 to December 31, 1943.

47. Plaintiff filed a corporation income tax return and an excess profits tax return for the taxable year 1944 with the Collector of Internal Revenue, Nashville, Tennessee. Said returns indicated an income tax liability of $231,296.55 and an excess profits tax liability of $481,444.74, or a total tax liability of $712,741.29. This total tax was paid to said Collector in installments as follows: $333,825.00 on or about March 15, 1945; $360,000.00 on or about June 15, 1945 and $18,916.29 on or about November 11, 1945.

48. Subsequent to the filing of the income and excess profits tax returns for the taxable year 1944, plaintiff received tentative carry-back refunds in the amount of $21,646.96 by a check dated February 20, 1947 and $62,315.37 by a check dated June 12, 1947. The amount of $21,646.96 was the difference between an excess profits tax overassessment in the amount of $40,677.24 and an assessed deficiency of income tax in the amount of $19,030.28. The amount of $62,315.37 was the difference between an excess profits tax overassessment in the amount of $290,542.41 and an assessed deficiency of income tax in the amount of $228,227.04.

49. A Revenue Agent's Report dated June 20, 1949 (Exhibit H) indicated an overassessment of income tax in the amount of $85,441.67 and an additional excess profits

tax in the amount of $306,366.27 for the taxable year 1944 or a net deficiency of $220,924.60.

50. On or about December 27, 1949, plaintiff paid $220,924.60 to the Collector of Internal Revenue, Nashville, Tennessee. Said payment discharged plaintiff's liability for the net tax deficiency indicated in the aforesaid Revenue Agent's Report for the taxable year 1944.

51. Prior to the expiration of the period of limitation upon assessment of additional income and excess profits taxes for the calendar year 1944, consents executed by plaintiff and accepted by the Commissioner of Internal Revenue were filed extending the period of limitation upon assessments for said period to December 31, 1950.

52. On or about June 28, 1951, within the period of limitation prescribed by Section 322(b)(1) of the Internal Revenue Code of 1939, plaintiff filed with the Collector of Internal Revenue, Nashville, Tennessee, a claim for refund of the sum of $398,981.36 or such greater amount including interest as is legally refundable with respect to the taxable year 1944. Said sum represented income and excess profits taxes claimed to have been overpaid by plaintiff.

53. The Collector of Internal Revenue at Nashville, Tennessee, in a letter addressed to plaintiff under date of August 1, 1951 acknowledged receipt on June 28, 1951 of the claim for refund referred to in paragraph "52" hereof. A photostatic copy of said letter is hereto attached as Exhibit S.

54. On or about August 9, 1951, pursuant to a written request dated August 1, 1951, from the Collector

of Internal Revenue, Nashville, Tennessee, plaintiff filed with said Collector a supplementary claim with respect to taxable year 1944. In said supplementary claim plaintiff demanded a refund of excess profits taxes in the amount of $456,591.36. Plaintiff also returned to said Collector the claim originally filed with him on June 28, 1951, as stated in paragraph "52" hereof. A copy of plaintiff's letter of transmittal of said claims to the Collector is hereto attached as Exhibit T.

55. On or about April 24, 1957, the Commissioner of Internal Revenue notified The Memphis Street Railway Company by registered mail of the rejection and disallowance of all the aforesaid claims for refund with respect to taxable year 1944.

56. Plaintiff filed a corporation income tax return for the taxable year 1947 with the Collector of Internal Revenue, Nashville, Tennessee. Said return indicated an income tax liability of $56,074.27 for the taxable year 1947. This total tax was paid to said Collector in installments as follows: $20,000 on or about March 15, 1948; $8,037.14 on or about June 11, 1948; $14,018.57 on or about September 13, 1948 and $14,018.56 on or about December 10, 1948.

57. A Revenue Agent's Report dated June 20, 1949 (Exhibit H) indicated an income tax deficiency in the amount of $9,235.32 for the taxable year 1947. Said deficiency was assessed and plaintiff paid $9,235.32 to the Collector of Internal Revenue, Nashville, Tennessee, on or about December 27, 1949.

Appendix B

58. On or about February 16, 1950 plaintiff paid $746.41 to the Collector of Internal Revenue, Nashville, Tennessee, representing interest from March 15, 1948 to July 20, 1949 on the indicated income tax deficiency in the amount of $9,235.32 for the taxable year 1947.

59. On or about May 9, 1951, within the period of limitation prescribed by Section 322(b)(1) of the Internal Revenue Code of 1939, plaintiff filed with the Collector of Internal Revenue, Nashville, Tennessee, a claim for refund of the sum of $37,796.41 or such greater amount including interest as is legally refundable with respect to the taxable year 1947.

60. On or about April 24, 1957, the Commissioner of Internal Revenue notified The Memphis Street Railway Company by registered mail of the rejection and disallowance of the aforesaid claim for refund with respect to the taxable year 1947.

61. Plaintiff's books of account have been maintained and its tax returns have been filed for all periods here involved on an accrual basis.

62. Plaintiff's income for the period January 1, 1943 to March 31, 1943 was reported in the consolidated income tax return filed by National Power & Light Company and affiliates, and plaintiff's income for the period April 1, 1943 to December 31, 1943 was reported in a separate return filed by plaintiff for said period. Plaintiff's books of account have been maintained and its tax returns for all periods here involved have been filed on a calendar year basis.

Appendix B

63. Should this Court find for the plaintiff in this action the parties hereto agree that the determination of the amount due plaintiff pursuant to such finding shall be made under Rule 38(c) of the Rules of this Court and that if such determination reveals an overassessment of income or excess profits tax and a deficiency of income or excess profits tax for the same taxable year said deficiency shall be applied in reduction of said overassessment for said taxable year.

64. The foregoing is in addition to the admissions contained in defendant's answer to plaintiff's petition.

/s/ E. Roy Gilpin
Attorney for Plaintiff

/s/ Charles K. Rice
Attorney for Defendant

/s/ Harold S. Larsen
Harold S. Larsen
Attorney.

APPENDIX C

Statutes and Regulations Involved

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

(53 Stat. 1, 13)

* * * * *

(l) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

* * * * *

(53 Stat. 1, 14, as amended by 26 U.S.C. (Supp. II, 1940 ed.))

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(53 Stat. 1, 40, as amended by 26 U.S.C. (Supps. I-V 1940 ed.))

* * * * *

SEC. 718. EQUITY INVESTED CAPITAL.

(a) *Definition.*—The equity invested capital for any day of any taxable year shall be determined

as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—

(1) *Money paid in.*—Money previously paid in for stock, or as paid-in-surplus, or as a contribution to capital;

(2) *Property paid in.*—Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in-surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. If the property was disposed of before such taxable year, such basis shall be determined under the law applicable to the year of disposition, but without regard to the value of the property as of March 1, 1913. If the property was disposed of before March 1, 1913, its basis shall be considered to be its fair market value at the time paid in. If the unadjusted basis of the property is a substituted basis, such basis shall be adjusted, with respect to the period before the property was paid in, by an amount equal to the adjustments proper under section 115(1) for determining earnings and profits;

* * * * *

(4) *Earnings and profits at beginning of year.*—The accumulated earnings and profits as of the beginning of such taxable year;

* * * * *

(54 Stat. 974, as amended by 26 U.S.C. (Supp. II, 1940 ed.)).

* * * * *

Appendix C

Treasury Regulations 112, promulgated under the Internal Revenue Code of 1939:

SEC. 35.718-1. *Determination of Daily Equity Invested Capital—Money and Property Paid In.*—The equity invested capital for any day is determined as of the beginning of such day. The basis or starting point is found in the amount of money and property previously paid in for stock, or as paid-in-surplus, or as a contribution to capital. The terms "money paid in" and "property paid in" do not include amounts received as premiums by an insurance company subject to taxation under section 204. For the purpose of determining equity invested capital, the amount of any property paid in is the unadjusted basis to the taxpayer for determining loss upon a sale or exchange under the law applicable to the taxable year for which the invested capital is being computed. If the property was disposed of after February 28, 1913, and before such taxable year, such unadjusted basis shall be determined under the law applicable to the year of disposition, but without regard to the value of the property as of March 1, 1913; if the property was disposed of before March 1, 1913, its unadjusted basis shall be considered to be its fair market value at the time paid in.

If the basis to the taxpayer is cost and stock was issued for the property, the cost is the fair market value of such stock at the time of its issuance. If the stock had no established market value at the time of the exchange, the fair market value of the assets of the company at that time should be determined and the liabilities deducted. The resulting net worth will be deemed to represent the total value of the outstanding stock. In determining

net worth for the purpose of fixing the fair market value of the stock at the time of the exchange, the property paid in for such stock shall be included in the assets at its fair market value at that time.

If stock having no established market value is issued for intangible property, and it is necessary to determine the fair market value of such property, the following factors, among others, may be taken into consideration in determining such value: (a) the earnings attributable to such intangible assets while in the hands of the predecessor owner; and (b) any cash offers for the purchase of the business, including the intangible property, at or about the time of its acquisition. A corporation claiming a value for intangible property paid in for stock should file with its return a full statement of the facts relating to such valuation.

* * * * *

"Sec. 35.718-2. Determination of daily equity invested capital—Accumulated earnings and profits. —(a) In general.—

"The term 'accumulated earnings and profits' is not defined in the Internal Revenue Code. See, however, section 115 and the regulations prescribed thereunder as to the effect of certain transactions on earnings and profits, and section 35.718-5 as to the effect of the declaration and distribution of dividends. In general, the concept of 'accumulated earnings and profits' for the purpose of the excess profits tax is the same as for the purpose of the income tax. As to determination of additional amount to be included in daily equity invested capital on account of new capital, see section 35.718-4. In computing accumulated earnings and profits as of the beginning

of the taxable year, a taxpayer keeping its books and making its income tax returns on the accrual basis shall subtract the income and excess profits taxes for the preceding taxable year. If there is a deficit in the accumulated earnings and profits as of the beginning of the taxable year, such deficit shall not be taken into account in determining invested capital, and in such cases the earnings and profits as of the beginning of the taxable year shall be considered as zero, but subsequent earnings and profits shall be applied against such deficit. Unrealized appreciation in value of property is not a factor in determining earnings and profits."

* * * * *

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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 153

MEMPHIS TRANSIT COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims (Pet. 1a-31a) is reported at 297 F. 2d 542.

JURISDICTION

The order and judgment of the Court of Claims were entered on December 6, 1961. (Pet. 1, 8a.) Taxpayer's timely motion for a rehearing was denied on March 7, 1962. (Pet. 2.) The petition for a writ of certiorari was filed on June 2, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTIONS PRESENTED

1. Whether the Court of Claims was correct in finding that shares issued by taxpayer to another corporation whose properties it acquired were not in fact part of the consideration paid for those properties.

2. Whether, in computing excess profits tax credit on the invested capital method under the 1939 Code, accumulated earnings and profits should be reduced by income and excess profits tax liabilities for the preceding year as the liabilities existed at the close of that year (as the court below held), or as ultimately decreased by the allowance of net operating loss and unused excess profits credit carrybacks from subsequent years.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Section 718 of the Internal Revenue Code of 1939 and Section 35.718-2 of the Treasury Regulations 112 (1939 Code), are set out in the Appendix, *infra,* pp. 10-11.

STATEMENT

Two unrelated issues are presented by this suit for refund of income and excess profits taxes for the years 1943, 1944 and 1947. The first, a question of fact, involves a stock transfer in 1905 which, if considered a part of the consideration paid for certain corporate properties then acquired by taxpayer, increases the basis for computing obsolescence losses upon the subsequent abandonment of those properties and reduces the basis for computing taxpayer's excess profits. The second issue involves the meaning of the term "income and excess profits taxes for the preceding taxable year," as used in the Regulations defining "accumulated earnings and profits" for the purpose of comput-

ing excess profits taxes by the equity invested capital method. The Court of Claims upheld the Commissioner on both questions.

1. Taxpayer, a corporation, is engaged primarily in the operation of a motor bus and trackless trolley system in Memphis, Tennessee. Prior to 1945, taxpayer operated an electric street railway system in Memphis. The latter operation was gradually abandoned between 1945 and 1947. (Pet. 8a, 9a.)

In 1905, the Memphis Street Railway Extension Company received a franchise to operate and maintain a street railway system consisting of extensions of lines operated by taxpayer. The Extension Company never operated a streetcar, but it did construct 14.9 miles of rail in 27 extensions to taxpayer's lines and acquired cars, powerhouse equipment, buildings, fixtures and miscellaneous other items. (Pet. 13a-15a.)

On December 18, 1905, taxpayer entered into an agreement with the Extension Company whereby the latter agreed to sell to taxpayer all of its property in exchange for $700,000 of taxpayer's 5% bonds and 25,000 shares of taxpayer's common stock. The properties transferred were to be free and clear of all indebtedness, except the obligation of the Extension Company to pay $650,000 of its notes held by Isidore Newman & Sons, which it agreed to pay upon receipt of the purchase price from taxpayer. (Pet. 16a-17a.)

Although taxpayer had no preferred stock and only 5,000 shares of common stock before entering into the contract, its shareholders, on December 18, 1905, authorized the Company to issue 25,000 shares of preferred stock to the holders of the old common stock, which was retired, and 25,000 shares of new common

stock to the Extension Company. Immediately prior to the recapitalization 4,989 of taxpayer's 5,000 shares of outstanding common stock were held by Isidore Newman & Sons, who also held 495 of the Extension Company's 500 outstanding shares. (Pet. 16a, 17a.)

The improvement costs of the Extension Company, including the physical properties acquired from it by taxpayer, amounted to $700,000, the same amount as the bonds which it received. It had never established a value for its franchise on its books and there was no evidence that it ever intended to operate, or that it could have operated profitably, except as an adjunct of taxpayer's system. (Pet. 28a, 30a.)

Under these circumstances, taking into account the common ownership of taxpayer and the Extension Company, the Court of Claims concluded that the $700,000 in bonds represented the fair and reasonable net value of all assets acquired by taxpayer, and that no consideration reasonably could be attributed to the 25,000 shares (fair market value $70 per share) issued by taxpayer to the Extension Company. (Pet. 27a-28a, 30a, 31a.) Accordingly, the Court of Claims sustained the determination of the Commissioner of Internal Revenue that the share transfer cannot increase the cost basis of the property acquired by taxpayer from the Extension Company, relevant in computing obsolescence losses upon the abandonment of this property during the period 1945-1947, or the equity invested capital basis upon which taxpayer's excess profits are computed. (Pet. 13a, 26a-27a, 31a.)

2. Taxpayer operated at a loss in the years 1945 and 1946. As a result of carrybacks of net operating losses and unused excess profits credits for those years, its income and excess profits tax liabilities were reduced

for the taxable years 1943 and 1944. (Pet. 26a.) In computing taxpayer's excess profits credit on the equity invested capital basis, accumulated earnings and profits at the beginning of the taxable year must be included. The accumulated earnings and profits must be reduced, however, by the income and excess profits taxes for the preceding year. In making the latter adjustment in computing taxpayer's credits for 1944 and 1945, the Commissioner used the 1943 and 1944 income tax liabilities existing prior to the application of the carryback of net operating losses and unused excess profits credits from 1945 and 1946. (Pet. 26a.) Taxpayer maintained in the Court of Claims that the proper amounts were its taxes after the application of such carrybacks. (Pet. 26a.) This legal issue, essentially a matter of statutory interpretation, was decided adversely to the taxpayer; the Court of Claims sustained the method of computation used by the Commissioner. (Pet. 6a-8a.)

ARGUMENT

The decision below is correct. There is no conflict, nor any other reason to grant further review.

1. Whether or not the 25,000 shares of stock issued by taxpayer constituted part of the consideration for property which it acquired from the Extension Company is, ultimately, a question of fact. It remains a question of fact, even though it may be necessary for the lower court to draw inferences from stipulated basic facts. *United States* v. *Gypsum Co.*, 333 U.S. 364 394.

The Court of Claims, after careful consideration of the whole record, found, on substantial evidence, that the property acquired by taxpayer did not exceed in

cost the value of the bonds issued with the stock, that the franchise of the Extension Company had no determinable value, and that the shareholders of both corporations were practically identical. On the basis of those findings, it reasonably concluded that no consideration could be attributed to the issuance of taxpayer's 25,000 shares to the Extension Company. Taxpayer assails this finding solely on the ground that it is contrary to the stipulated basic facts. (Pet. 10-13.)

The argument is that, since it was both stipulated and found that the Extension Company offered to convey its property to taxpayer at an agreed purchase price of 25,000 shares of stock and $700,000 in bonds and that the agreement was carried out according to its terms (Pet. 16a-17a, 7b-8b), the Court of Claims was precluded from inquiring further whether the stock was in fact a part of the consideration paid by taxpayer. (Pet. 10-13.) But the parties stipulated no more than (1) the terms of the offer, (2) that the property was in fact received by taxpayer, and (3) that both the stock and the bonds were in fact received by the Extension Company. It cannot be assumed—and the Court of Claims did not so assume—that the government, intentionally or through inadvertence, stipulated away the principal factual issue in the case.

The fact of the matter is that the Court of Claims applied the familiar rule that the substance and not the form of a transaction controls for income tax purposes. As it said, "this court will not permit the corporate image to serve as blinders when it seeks to answer the question as to what actually occurred here, but will look at the facts in each situation." (Pet. 4a.) In this it was clearly correct.

2. The second issue raised by taxpayer involves the computation of its excess profits credit by the equity invested capital method. Under Section 718(a)(4) of the 1939 Code (Appendix, *infra*, pp. 10-11), accumulated earnings and profits at the beginning of the taxable year are included in equity invested capital. Section 35.718-2 of Treasury Regulations 112 (Appendix, *infra*, p. 11) provides that accumulated earnings and profits should be reduced by the amount of income and excess profits taxes for the preceding taxable year. Rev. Rul. 55-28, 1955-1 Cum. Bull. 359, requires that taxes be computed for this purpose without the benefit of any net operating loss or unused excess profits credit carry-back.

Taxpayer challenges the Revenue Ruling—which was upheld by the Court of Claims—contending that the taxes used in computing accumulated earnings and profits should be reduced by carrybacks from subsequent years. The practical result of the adjustment advocated by taxpayer would be that a carryback from 1945 to the year 1943 not only would produce a tax reduction in 1943 but would also reduce its taxes for 1944.[1]

As the Court of Claims pointed out, the method of computation urged by taxpayer does not conform to the normal principles of tax reporting on the accrual method and is contrary to the rationale of *Lewyt Corp.* v. *Commissioner*, 349 U.S. 237, in which this Court held that carrybacks do not operate retroactively to alter

[1] This double benefit or windfall would result from reducing 1943 taxes, thereby increasing accumulated earnings and profits on hand at the beginning of 1944, which, in turn, would increase the excess profits credit for 1944, and, ultimately, reduce the excess profits tax for 1944.

taxes accrued in prior years. (Pet. 8a.) Taxpayer argues, however, that an adjustment to accumulated earnings and profits is necessary in order to reflect its "true financial status" as of the end of the year. (Pet. 14.) Thus, taxpayer maintains that its "true financial status" as of the end of 1943, for instance, cannot be determined without an adjustment of tax liability based upon a carryback from 1945, despite the fact that the carryback depends upon business losses in 1945. This novel proposition, dubious on its face, finds no support in the jurisprudence or the legislative history of the excess profits statutes.

Taxpayer mistakenly asserts a conflict "in principle" (Pet. 14-16) between the instant decision and *Drybrough* v. *Commissioner*, 238 F. 2d 735 (C.A. 6), and *Pacific Affiliate* v. *Commissioner*, 224 F. 2d 578 (C.A. 9). Apart from the fact that *Drybrough* did not involve the computation of an excess profits credit, both of the latter cases stand only for the proposition that adjustments should be made to accumulated earnings and profits irrespective of the fact that the final determination of the tax liabilities may not be made until a later year. The obviously crucial distinction which taxpayer overlooks is that the liabilities in *Drybrough* and *Pacific Affiliate* were based upon events of the taxable year, and it was only the final determination of such liabilities which was deferred, whereas in the case at bar the theory advocated by taxpayer would require the liabilities to be based upon business conditions and other events in subsequent years.

Finally, the adjustment urged by taxpayer is inconsistent with the legislative purpose underlying the computation of excess profits credits on the equity invested capital basis. That purpose was to provide a measure

by which the amount of excessive profits might be judged. *West Construction Co.* v. *Commissioner*, 7 T.C. 974, 978. A credit based upon capital allows a fair return on the investment which is actually available for use in a taxpayer's business during that taxable year. If a component of that capital, *e.g.*, accumulated earnings and profits, is increased as a result of events in subsequent tax years, the resulting computation of capital for the taxable year is to that extent fictitious.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

ARCHIBALD COX,
Solicitor General.

LOUIS F. OBERDORFER,
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JULY, 1962

APPENDIX

Internal Revenue Code of 1939:

SEC. 718 [as added by Sec. 201, Second Revenue Act of 1940, c. 757, 54 Stat. 974]. EQUITY INVESTED CAPITAL.

(a) *Definition.*—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—

(1) *Money paid in.*—Money previously paid in for stock, or as paid-in surplus, or as a contribution to capital;

(2) [as amended by Sec. 218, Revenue Act of 1942, c. 619, 56 Stat. 798] *Property paid in.*—Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. If the property was disposed of before such taxable year, such basis shall be determined under the law applicable to the year of disposition, but without regard to the value of the property as of March 1, 1913. If the property was disposed of before March 1, 1913, its basis shall be considered to be its fair market value at the time paid in. If the unadjusted basis of the property is a substituted basis, such basis shall be adjusted, with respect to the period before the property was paid in, by an amount equal to the adjustments proper under section 115(l) for determining earnings and profits;

* * *

(4) *Earnings and profits at beginning of year.*—The accumulated earnings and profits as of the beginning of such taxable year; * * *

* * *

(26 U.S.C. 1952 ed., Sec. 718.)

Treasury Regulations 112 (1939 Code):

SEC. 35.718-2. Determination of Daily Equity Invested Capital—Accumulated Earnings and Profits.—(a) *In General.*—

The term "accumulated earnings and profits" is not defined in the Internal Revenue Code. See, however, section 115 and the regulations prescribed thereunder as to the effect of certain transactions on earnings and profits, and section 35.718-5 as to the effect of the declaration and distribution of dividends. In general, the concept of "accumulated earnings and profits" for the purpose of the excess profits tax is the same as for the purpose of the income tax. As to determination of additional amount to be included in daily equity invested capital on account of new capital, see section 35.718-4. In computing accumulated earnings and profits as of the beginning of the taxable year, a taxpayer keeping its books and making its income tax returns on the accrual basis shall subtract the income and excess profits taxes for the preceding taxable year. If there is a deficit in the accumulated earnings and profits as of the beginning of the taxable year, such deficit shall not be taken into account in determining invested capital, and in such cases, the earnings and profits as of the beginning of the taxable year shall be considered as zero, but subsequent earnings and profits shall be applied against such deficit. Unrealized appreciation in value of property is not a factor in determining earnings and profits.

* * *

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